# FOREIGN ASSISTANCE AND RELATED PROGRAMS APPROPRIATIONS FOR 1987

# HEARINGS

BEFORE A

SUBCOMMITTEE OF THE

## COMMITTEE ON APPROPRIATIONS
## HOUSE OF REPRESENTATIVES

NINETY-NINTH CONGRESS

SECOND SESSION

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# FOREIGN ASSISTANCE AND RELATED PROGRAMS APPROPRIATIONS FOR FISCAL YEAR 1987

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TUESDAY, MARCH 4, 1986.

## SECRETARY OF STATE

### WITNESSES

**HON. GEORGE P. SHULTZ, SECRETARY OF STATE**

**HON. M. PETER McPHERSON, ADMINISTRATOR, AGENCY FOR INTERNATIONAL DEVELOPMENT**

**HON. WILLIAM SCHNEIDER, JR., UNDER SECRETARY FOR SECURITY ASSISTANCE, SCIENCE AND TECHNOLOGY, DEPARTMENT OF STATE**

Mr. OBEY. The hearing will come to order.

I would like to welcome our primary witnesses: The Honorable George P. Shultz, Secretary of State, accompanied by the Honorable M. Peter McPherson, Administrator, Agency for International Development; and the Honorable William Schneider, Jr., Under Secretary for Security Assistance, Science and Technology, Department of State.

Today, the committee will hear testimony from Secretary of State, George Shultz, concerning the Administration's request for fiscal year 1987 foreign assistance appropriations and for other foreign policy matters.

The committee currently has pending: a $15.5 billion 1987 request, which works out to a 16.2 percent increase above 1986 actual spending levels or approximately $2.1 billion more than is currently available (excluding funding for the Export-Import Bank which I do not consider foreign aid); a $51.7 million 1986 rescission for international operations and programs; and a $54 million 1986 supplemental budget request, primarily for a special contingency fund in the Economic Support Funds account.

Perhaps, Mr. Secretary, in your statement you could explain to us what the purpose of this fund is.

I should note that this committee provided a special requirements fund of $20 million in ESF in its 1986 bill. However, as you remember, the Senate objected strongly, and in conference the fund was eliminated.

First, Mr. Secretary, I want to welcome you before the committee, and I want to express our satisfaction with the very fortunate chain of events in the Philippines which culminated in Mrs. Aquino's presidency.

I think events in the Philippines are instructive. Each time Congress tried to prod the Marcos Government on human rights, or on military reform, we were criticized in some quarters by those who warned that the only alternative to Marcos was the communists. I think the Filipinos demonstrated there were a lot of alternatives.

Mr. Secretary, I think a lot of people have the right to be pleased. I think the Congress over the past few years exerted constructive pressure on the Marcos Government.

I think the Administration was initially late in sending the right signals to Mr. Marcos. But over the last year or so, the Administration policy has been good, and I think that people like you and Senator Lugar deserve special credit for making sure that the President, despite his understandable reluctance, in the end made the right decision.

We all hope, and we know that you share in our hopes, that Mrs. Aquino and her advisors and colleagues prove to be capable, fair and humane leaders for the Philippine people. They have an extraordinary number of difficult economic, political and military tasks to accomplish.

Mr. Secretary, now I would like to turn to the Administration's foreign aid budget request for this year. There is much in your budget request that I support.

We all share in your belief in a strong American leadership role in the world, even though we may differ on occasion in our judgment about how that leadership should be exercised.

Mr. Secretary, last year the Administration requested $14.97 billion for foreign assistance from this committee, excluding the Export-Import Bank. This 1986 request included an increase of $754 million in military programs and an increase of $198 million in ESF. The committee cut those security requests by $1.127 billion. The final conference cut that request by $994.5 million. This cut in security assistance was later deepened by the Gramm-Rudman sequestration process to a total of $1.413 billion.

Last year, there were really two major issues between the Administration and the committee. We had some disagreements on priorities and we disagreed on the total funds necessary for foreign assistance programs because of budgetary constraints.

The final figures show that last year the Administration requested $14.97 billion, and after our cuts and Gramm-Rudman it received $13.3 billion, almost a $1.7 billion cut in the total.

I know you wish the committee could have provided you with more, but under the fiscal circumstances we had no choice but to cut. I believe we were responsible in doing so.

This year's budget squeeze will make last year's budget problems look like patty cake. Again, we will have differences, and again, we will have difficulty meeting your request because, exclusive of the Export-Import Bank, the Administration is asking for a $2.1 billion increase.

Mr. Secretary, from 1981 until 1985 the administration succeeded in raising foreign aid by $7.8 billion in budget authority. That is an increase of 123 percent. That increase stopped last year because of the actions of this committee.

Now you are asking for $2 billion more than the 1986 level, virtually all of that on the military side. Development assistance is up 7 percent, $174 million, but military assistance is up by 17 percent, $959 million, of which grant military assistance is up by 40 percent, $298 million in your new request.

Mr. Secretary, that increase has helped produce the budget priorities we see depicted on that chart over at the end of the room. Since it is rather pale, I think I will use my own hand charts to demonstrate the vise you are going to be running into this year up here.

This chart represents the way the Federal tax dollar was distributed in 1980. We provided 37 cents out of every dollar for programs to support the elderly or the disabled. We provided 7 cents out of every dollar for programs that supported the non-elderly poor. We provided 9 cents on every dollar for interest payments on the national debt. We provided 25 cents on every dollar for defense, foreign affairs, foreign aid, support of embassies abroad, things like that. Everything else the government did made up 21 cents out of the dollar.

If you take a look at how that compares with the budget presentation that we are dealing with today, we are still providing under the President's budget this year about 37 cents on every dollar, in spite of all the arguments we have had about social security and all the rest.

Seniors are still getting about 37 cents out of every dollar. That hasn't changed from 1980 to 1987.

Programs we provide for the non-elderly poor, this little red piece on the chart, provides about 5½ cents on every dollar as opposed to the 7 cents we were providing in 1980.

Interest, as you know, has grown—the green piece here from 9 cents on the dollar to 15 cents on the dollar.

Programs that go to support defense and foreign aid and support of our embassies have grown from 25 cents on the dollar to 31 cents on the dollar over that period.

Everything else the government does is being cut in half, from 21 cents on the dollar to 11 cents on the dollar this year. That is the investment portion of the budget. It is everything we invest in kids, by way of education, in science, by way of technology research or medical research, everything we invest in workers by way of job training, everything we invest in community infrastructure to make our communities the place where business can make a buck and where people can make a decent wage.

We are asked to take under the budget this year a reduction in cancer research by $73 million, a reduction in heart disease research by $62 million, a reduction in AIDS research by $31 million, student financial assistance cut by one-quarter, job training cut by 17 percent, transportation cut by $5 billion, agriculture by $8 billion.

In contrast, the military budget is being increased by 12 percent over last year's Gramm-Rudman levels in nominal dollar terms. The foreign aid bill is up about 16 percent over those same levels. Grant military aid is up by 33 percent.

Mr. Secretary, I honestly believe that if the Administration is serious about this budget request, the best way for you to make us take that budget request seriously is if you can convince the President that budget priorities like this are unrealistic. The country is not asking for reductions in cancer research and education opportunity in order to finance foreign aid programs or a military buildup.

I honestly believe that you and Secretary Baker and the other Cabinet Secretaries who have a direct operational responsibility for the programs that come before this subcommittee need to convince the President and the Congress that we can't afford to take 70 percent of spending off the table as Gramm-Rudman does. The President can't afford to take revenues off the table or military spending off the table, and Democrats can't afford to take entitlements off the table. I think we have got to get off our first preferences and get down to the realities.

It is because I believe that the President will not accept the deep military cuts that would be required, and because I believe the American people will not accept significant reductions in programs like cancer research and the rest that I believe that that grand compromise is going to have to include revenues. I think we are kidding ourselves if we don't face up to that fact.

Mr. Secretary, nobody is talking about increasing income taxes. What they are talking about is using some portion of the minimum tax which is raised from requiring that corporations and individuals who up to this point have escaped their fair share of taxes—what we are suggesting is that you use a portion of that revenue in order to fund deficit reduction at least until the deficit gets down to about half of where it is now.

Mr. Secretary, it may seem strange that I am talking to the Secretary of State about revenues, but the fact is that we have a specific problem this year, and I don't think the people around this town have focused on it. In the past, we have been able to deal with foreign aid by putting it in the continuing resolution. So we haven't had it up or down on the vote. We haven't had a confrontation on a lot of amendments.

We can't do that this year. We can't do that because Gramm-Rudman requires that all appropriation bills be finished before July. That means we have to take the bill out on to the Floor.

Mr. Secretary, I can't pass a foreign aid bill on the House Floor, no matter what shape it is in, so long as the Members of the House see that we are increasing foreign aid and we are paying for that increase by gutting cancer research, gutting educational opportunity, and things of that nature. I just don't think the votes are there on either side of the aisle, frankly.

Now, Mr. Secretary, last year I told the Administration that this committee would cut their military aid request by a billion dollars. They didn't believe it; but we did it. What I am suggesting to you now is that if no grand compromise is reached by the time this bill is brought to the Floor—we will be finished with our hearings by the end of March and ready to mark up—then this committee will have no choice but to report a bill which both you and I believe is totally inadequate.

It would probably, in my judgment, based as I see it now—it would probably provide Gramm-Rudman funding levels for our Middle East commitments and nothing for any other portion of the bill. That is not responsible. But neither is a continued deadlock on the budget.

And I think it is important to face the fact that a great country has two obligations. It has to defend its interests around the world; it also has to pay its bills. If it is not going to pay its bills, then maybe we have to face the fact that we don't—that we aren't really willing to sacrifice to the degree necessary to exercise our leadership responsibility in the world.

I hope that is not true. I hope we demonstrate otherwise.

As I indicate, the reason I raised this with you is because, as a former OMB Director, as a former Secretary of the Treasury, with a distinguished career before you occupied the seat which you now occupy in that Cabinet room, I think you know what the realities are. And I think we all know what has to be done if we can just quit the Alfonse and Gaston routine and get about doing it.

I think the budget that you are presenting today indicates that the Administration has not done something that is required of every program manager on the domestic side. It hasn't made choices. Over the past five years, the Administration has been pushing through crushing cutbacks at home, but it has done the opposite in this bill.

In 1980, the United States was giving ESF assistance to 21 countries. Today, we are giving ESF assistance to 47. Over that same period, we have raised the number of countries getting MAP grant assistance—that is free military assistance—from 5 to 38. It has raised the number of countries receiving IMET from 63 to 97. This year, it is again adding new countries to those programs.

On concessional low-interest loans, it is doing the same thing, increasing them significantly, while Congress is being asked to cut back on loans to students and farmers here at home.

So, Mr. Secretary, the committee will be happy to hear your testimony here today. We welcome you. But when it is over, I am going to ask you to go back to the drawing board and resubmit your budget.

By March 30, as I indicated, we are going to be ready to put out a bill. We need to know how the Administration would distribute massive cuts that I believe are going to be required in this bill without a budget compromise between the President and the Congress.

What I specifically need to know is how you would distribute those massive cuts if we were to give you, say, $1 billion in additional—in addition to our Middle East requirements, if we were to give you $1 billion on the economic side and $1 billion on the military side, and say that is all there is until we decide we are going to pay our bills.

We would like to know where you would suggest that we put that money, because I very honestly believe that at most that is what we are going to be able to get out of the House this year by way of foreign assistance, unless we have a compromise at the very top levels of this government.

Mr. Secretary, I was going to ask Mr. Kemp for whatever comments he had before you proceeded. I understand he is at a leadership meeting. Perhaps Mr. Edwards would like to make a comment before I ask you to begin your testimony.

Mr. **Edwards**. Thank you, Mr. Chairman.

Mr. Secretary, first of all, let me join the Chairman in his comments praising the recent successes of the Administration's foreign policy. Let me also suggest that the role the Administration played in the Philippines, and the role that the Administration played in Haiti, in allowing both those situations to develop without the bloodshed that might have developed, were not only very fine chapters in American foreign policy, but I think a continuation of what has been a very successful—perhaps not spectacular but very successful—foreign policy under your stewardship. I want to compliment you on that.

Let me speak just a word about two other items. One is related to Nicaragua. I know of nothing, either morally or legally, that requires the United States to sit passively while a foreign power like the Soviet Union attempts to establish a military beachhead only hours away from this country. And I personally praise you and the Administration for the aggressive commitment that you are making to try to do something to prevent that from happening.

On a less positive note, perhaps, I want to echo some of the concerns that have been expressed by the Chairman in terms of the foreign operations budget. I do not believe for one moment that the Chairman speaks for the rest of the committee necessarily when he appeals to you to pay for your foreign aid program by pushing for higher taxes; nor do I really think that the Chairman can deliver on the threat that he has made that we can simply eliminate everything but the Middle East programs and one billion dollars each for all the remaining military and economic programs. I do not believe that Congress would support that position, which involves eliminating the security assistance and economic assistance programs that are important to the Nation.

So, I don't think that is a real threat. But I would, I think, have to caution you that probably not very many people on either side of the aisle would be willing to see an increase in the foreign assistance budget this year.

Now, I don't know what that means in terms of the kinds of compromises which are going to have to be made and the priorities which we are finally going to settle down at, but I think it is highly unlikely that in this atmosphere with Gramm-Rudman—and Gramm-Rudman only forces us to do what we should have been doing all along—it is not at all likely we will have a bigger foreign aid budget than we had last year.

The danger, if you are not forthcoming with helping us reassess the priorities, is that the people along this table will determine those priorities without the input from the Administration. I don't think that is good policy-making. I would much prefer that what comes out of this committee reflects the needs that are assessed by you, by the President, and the other people in the Administration.

So, I want to welcome you here. I don't think you can take all of Mr. Obey's threats too seriously, but the threat that we are not going to increase the foreign aid budget is probably very real.

Thank you, Mr. Chairman.

Mr. **Obey**. Mr. Secretary, with that minor difference of opinion, why don't you proceed.

Secretary **Shultz**. Thank you, Mr. Chairman.

I listened carefully to your opening comments, and Congressman Edwards'. We do have some very deep differences of opinion here.

Since you more or less declared my testimony irrelevant and invited me to come back later and tell you how I would do it differently, I will simply file those 38 pages of testimony for the record, if that is acceptable to you.

I think there is a great amount of good logic and important statements of achievements in it, and you don't get achievements for nothing. You don't support the interests of the United States around the world for nothing. You have to put in effort, and you have to put in resources. There isn't any question about it.

Nevertheless, I will take your advice and simply file that for the record, and I would like to make some comments extemporaneously, hoping that at some point somebody will think the testimony is worth reading.

### ECONOMIC DEVELOPMENTS

First of all, insofar as general economic developments are concerned, I think the characterization of the last five years as some sort of a disaster area for the United States is totally misplaced. If we look at the domestic economy, since the mid-1970s to 1982, we have had 10 million new jobs. Tell me a comparable time period when we have had that many new jobs created, Mr. Chairman.

At the present moment, if you take an index of the number of people working as a percentage of those in the population 16 years of age or older—in other words, the people that you would think of as at least potentially available for work—that percentage is at the highest in our history.

If you take a look at inflation, inflation compared with what it was five years ago, and through this disaster period that you identified is one-third the level.

Interest rates have now gotten below 7 percent nominal, and are coming down, and we have a yield curve that makes some sense for a change instead of the reverse yield curve that was present when this Administration arrived on the scene.

All this didn't happen because we went for a tax increase. Quite to the contrary, taxes were reduced; particularly marginal rates of taxation were reduced. That was of great benefit to the American people and to the American economy. And in the tax reform bill, which the House passed and which is now being worked on in the Senate, marginal rates are brought down further. I believe that is an unambiguous good thing.

I don't think the record shows at all that a tax increase is what the doctor ordered, nor does the last presidential election campaign suggest that the American people are dying to have their tax rates increased.

So, insofar as you characterize the domestic economic scene as a disaster area, I differ with you. I think it has been very good.

Now, that does not mean it is without problems, and the fact that we have this outside steps is a very big problem, in my opinion, and it is necessary to come to grips with it. The President has come to grips with it, completely within the framework of the Gramm-Rudman-Hollings bill, and has presented a budget that does make choices. And the President makes a choice in favor of the security and the promotion of the interests of the United States, a very clear choice.

His budget, as I say, does it totally within the confines of the Gramm-Rudman-Hollings bill.

### EDUCATIONAL OPPORTUNITY AND JOB TRAINING

You said, Mr. Chairman, that the President's budget, to use your words, would gut educational opportunity. I think that is completely wrong. In the first place, the Federal Government has nothing to do with most educational opportunity in this country. It is run by the States and localities, both higher education and grade and high school education.

You spoke about job training. I have done a lot of work on that subject over a long period of time. But, once again, while there is certainly a Federal role in the manpower training programs, job training is done by private industry and it is on the job training that is the most effective kind of training. So, to think that this budget guts that I think is all wrong.

I could go on down the list. I couldn't write down everything you said. But I tried to pick out a few phrases and ideas.

### PHILIPPINES

I appreciate very much your generous comments about the Philippines, although they were a little more generous to the Congress than they were to the President. But he was running things. You acknowledged that. I appreciate that.

But if we had the kind of approach to our economic assistance that you advocate, I do not know where that would leave us with respect to promoting our interests and helping the Philippines under current circumstances; nor do I know where it would leave us with respect to the many other base rights countries.

### WORLDWIDE INTERESTS

After all, in pursuing our interests around the world, we do have agreements with other countries by which we have access to harbors and airports and other facilities, and those have come about through agreements. You have to support those agreements. So, we do have a lot of interests around the world.

You are right in saying that an effort has been made during this Administration to expand our capacity to support those interests, and I think it has been a good thing. The evidence of esteem for the United States around the world and the security of our interests, despite all the problems—and we do live in a very dangerous world—is quite evident to anybody who travels around, as I did as a private citizen before this administration and as I did as a private citizen in the first year and a half or so of this Administration.

I recognize when you travel around as Secretary of State, you don't see the world the same way an average person does, and probably you don't see it as accurately as when you have to go someplace and figure out how you are going to get a plant built or do something, operate in the local economy. You get a different view of it.

So, I think on the whole things have progressed well, with all due respect to the great problems that there are, and that it has been due to the kinds of choices the President has made.

So, rather than say I will throw in my hand and try to figure out how to get along on a billion dollars, I would have to say to you I think that the President's choices—the President's budget is a good one. It advances the interests of the United States. It has been carefully considered. It is completely within the framework of the deficit reduction targets that have been set. And I will stand on that.

Finally, I will stand on the proposition that the President has put forward that this is not the time to increase taxes in any general way. Of course, there is in his budget, I might note, some revenues generated by such things as cigarette taxes; and I don't have in my mind all the different things. I didn't prepare myself for a general budget hearing. But that is the way you have pitched this, so I will try to put it all within that framework.

### BUDGET REQUEST

One other thing. I would like to point out to you that you have all referred to the large increases in our budget. Let me just remind you that the 150 account in 1985 actual was $26.4 billion. Our request last year was for $22.8 billion. Our request this year is for $22.6 billion.

I recognize that the Congress cut us last year to $20.8 billion, but that does not mean that is right and that we should just come back and accept that. We have come back, and the President has come back, and said this is what we think is right and proper and serves the interests of the United States.

So, our request that we have come in with for fiscal year 1987 is approximately the same, slightly down from the request we made to you at this time last year.

Thank you, Mr. Chairman.

[The statement of Secretary Shultz follows:]

STATEMENT BY

THE HONORABLE GEORGE P. SHULTZ

BEFORE THE FOREIGN OPERATIONS SUBCOMMITTEE

COMMITTEE ON APPROPRIATIONS

U.S. HOUSE OF REPRESENTATIVES

MARCH 4, 1986

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EMBARGOED UNTIL DELIVERY, SCHEDULED FOR APPROXIMATELY 9:30 A.M. EST, TUESDAY MARCH 4, 1986. NOT TO BE PREVIOUSLY CITED, QUOTED FROM, OR USED IN ANY WAY.

Mr. Chairman and Members of this Committee:

I welcome the opportunity to speak in support of the President's Fiscal Year 1987 foreign assistance budget request. Our request comes before this Committee at a time of great debate over how to reduce our federal budget deficit. As a former budget director, I know from experience that there are no easy choices. And I am determined to have the Department of State do its fair share in getting the federal budget under control. In fact, the greatest single contribution the United States can make to the economic well-being of the developing world is to get our own economic house in order.

As recent history demonstrates, strong U.S. growth and lower U.S. interest rates are crucial to the rest of the world, and to the developing countries in particular. For example, a fall of 2 percent in U.S. real GNP in 1982 resulted in a 13 percent decline in U.S. imports from developing countries, while 7 percent U.S. growth in 1984 was associated with an 18 percent rise in U.S. imports from the developing world.

U.S. interest rates are translated directly into interest payments required from indebted nations. In 1983, the U.S. prime rate fell from 15 to 11 percent. That year, interest payments fell by almost $9.5 billion, while the debt outstanding from developing countries actually increased. Greater fiscal discipline in the United States will help the U.S. economy stay on the moderate, non-inflationary growth path projected by the Council of Economic Advisers. This will be a double benefit to the developing countries: We will be a good market for their exports, and lower interest rates will relieve some of their daunting burden of debt. Together, a 4 percent growth in the U.S. and another drop in United States interest rates should improve their external position by approximately $10.4 billion in 1986 alone.

One of my responsibilities as Secretary of State is to present to you the essential costs of conducting a successful foreign policy. These costs cannot be wished away. They are required, if we are to safeguard our national security and international interests. We recognize we have a burden of proof to meet in requesting more funds. I can assure you that in preparing this budget, every attempt was made to economize.

Our foreign assistance request, which seems higher when compared to the post-Gramm-Rudman-Hollings levels of FY 1986, is essentially the same as we requested in FY 86. We are not seeking large increases in foreign assistance; rather, we are continuing to seek a level of resources adequate to meet our commitments and safeguard our interests. As the President has observed, national security has to be our government's highest priority. The resources we are requesting have been accommodated within the FY 87 budget and the $144 billion deficit target contained in the Gramm-Rudman-Hollings legislation.

Mr. Chairman, the support that Congress has provided in the past has been invaluable in strengthening America's position in the world. As I shall explain later in greater detail, the growth and deployment of our foreign assistance assets have contributed to major foreign policy successes:

-- The NATO Alliance is strong.

-- Democratic institutions have emerged throughout Latin America and in key countries elsewhere.

-- We have an enhanced security posture in Central America, the Caribbean, and the Pacific Basin.

-- There has been a dramatic shift in Third World economies away from statist solutions and towards free markets.

-- We have maintained the peace process in the Middle East, by an active diplomacy but also by steady support for our friends on both sides who are being asked to take risks for peace.

-- We have given effective support to those who fight for freedom and independence in their own countries.

We must consolidate and expand these accomplishments as we continue to explore new opportunities for peace and stability. To meet these objectives, we have constructed a budget which reflects our essential needs.

## Budget Overview

The FY 1987 budget request before this subcommittee totals $15.2 billion: $783 million above the FY 1986 "post-sequestration" levels; and $181 million above the amounts originally requested by the President for FY 1986.

The major area of increase over FY 1986 post Gramm-Rudman-Hollings levels is designed to restore security assistance to the amounts necessary to meet our international commitments and to pursue our priority foreign policy objectives. Helping our friends defend themselves is our first line of defense. As the President has said "dollar for dollar, our security assistance contributes as much to global security as our defense budget." We must not succumb to false economizing -- leaving ourselves and our friends more vulnerable in areas vital to international security. Vacuums that we create in countries or regions of strategic importance will soon be filled by those less interested in peace and stability than we are. In the long run, this will end up costing us much more than the short-term investments reflected in this request.

Mr. Chairman, I would like to address the four major objectives served by our foreign assistance programs: supporting the Middle East peace process; strengthening our alliances and cooperative defense relationships; promoting regional stability in Central America and the Caribbean; and supporting economic reforms and democratic forces throughout the world. These objectives are interrelated -- and crucial.

Nearly 34 percent of foreign assistance resources go to Israel and Egypt in support of our search for peace in the Middle East. Assistance to the base rights countries of Spain, Portugal, Greece, Turkey and the Philippines and to military access and front line states such as Kenya, Oman, Morocco, Korea, Pakistan and Thailand represents another 26 percent. Our efforts to promote regional stability in Central America and the Caribbean take another 11 percent.

There are other countries of importance to us which share our democratic values, such as India and Colombia; or where new democracies have emerged, such as Bolivia and Uruguay; or where fundamental economic reforms are taking place, such as Ecuador and Senegal; or that are simply strategically important to us, like the island states of the South Pacific.

When these countries prosper and remain free, they demonstrate to the world that the benefits of open societies and open economies transcend geographic size and cultural diversity. They deserve our moral and material support. The amount of funds we are seeking to support these countries is relatively small -- some 17 percent of the total foreign assistance request. The real and symbolic importance of these resources, however, is considerable.

All other country programs account for only 3 percent of the total foreign aid request. Some are poverty-stricken African states to which we are directing our humanitarian and technical assistance programs. Others, like Mozambique, are moving from the Soviet bloc toward genuine non-alignment. Still others, such as Burma and Peru, are active partners with us in the war against international narcotics trafficking. Finally, some 9 percent of our assistance goes to AID non-country programs and a number of generously beneficial efforts including the Peace Corps, refugee assistance and narcotics control efforts.

Mr. Chairman, we have done some tough pruning and made hard choices to come up with these priorities. It is a lean budget and, in our considered view, a minimum budget.

Further reductions would compound our risks, weaken our friends, and add to our dangers. Foreign assistance is a kind of insurance, shoring up our security. If we try to cut corners, we run the risk of greater dangers that could well exact much higher budgetary and foreign policy costs. If the FY 1987 budget is insufficient, as it is in FY 1986, to fund country programs adequately and to provide the flexibility necessary to meet new requirements in an ever changing world, we deny ourselves the opportunity to build and maintain constructive relationships with dozens of countries throughout the world serving a multiplicity of U.S. interests.

Let me now do a brief tour of the world to discuss the specific policy objectives I outlined earlier.

## The Search for Peace in the Middle East

The Middle East remains an important focus of attention. Profoundly committed to Israel's security, the U.S. has sought to strengthen and enhance its relationship with this important partner. At the same time, we have sought to nurture our relationships with the moderate Arabs states, which also have an important role to play in the search for stability in the region.

Over the past year, the U.S. has been engaged with Isreal and Jordan, with support from Egypt, in efforts to bring about direct negotiations between Isreal and its Arab neighbors. Our actions have been guided by our conviction that only through direct negotiations based on Security Council Resolutions 242 can a just and lasting settlement be achieved. A peaceful resolution of the Arab-Israeli dispute is the best guarantor of Israel's security and of the legitimate rights of the Palestinian people. It remains our view that Resolution 242 applies as well to the Golan Heights, and that Syria has a place at the peace table.

The U.S. is not prepared, however, to permit those opposed to peace to obstruct ongoing efforts. The stakes in the Middle East are substantial. Our approach to this challenge must not be fettered by impatience or by short-term setbacks which may be encountered. We must expect that progress will continue to be incremental and must be prepared to help the parties pursue our shared objective of a negotiated settlement in a determined and persistent fashion.

Egypt is uniquely situated to interact constructively with all the parties, and wants to help move the process forward.

We value President Mubarak's assistance and support. At the moment, Egypt is engaged in talks with Israel aimed at resolving the Taba border dispute and other bilateral issues, including the return of the Egyptian ambassador to Tel Aviv. We are hopeful these efforts will soon bear fruit.

We likewise continue to follow developments closely in Lebanon, where UNIFIL is playing an important role in helping to provide for stability in the south. Similarly, both the Multinational Force and Observers and the United Nations Disengagement Observer Force continue successfully to perform important peace-keeping functions in the Sinai and the Golan Heights respectively.

We are seeking $5.4 billion in economic and military assistance for Israel, Egypt, and Jordan. We are also in the process of reviewing with our friends in the region their needs for defensive arms. Meeting their legitimate defensive requirements is critically important to maintaining the credibility of our security role throughout the region and to preserving our role as mediator in the search for peace.

Above all, we must strengthen our friends in order to deny the Soviets any opportunities to subvert a region crucial to our interests.

## Israel's Economic Reforms

Last year, we sought, and Congress appropriated, $1.5 billion in supplemental assistance to support Israel's economic reform program. Buttressed by this assistance, Israel has made significant progress in stabilizing its economy since last summer. Prime Minister Peres' July 1 measures included a 19 percent devaluation of the shekel, cuts in government expenditures leading to a marked reduction in the budget deficit, a sharp decline in real wages, restrictive monetary policy, and price controls.

The combined impact of new fiscal and monetary measures on inflation has been dramatic. The monthly rate of inflation declined from 27.5 percent for the month of July to 1.3 percent in December. January prices actually fell by 1.3 percent. This has enabled the Israeli Government to keep the shekel/dollar exchange rate stable. Meanwhile, the positive trend in the balance of payments, which began in late 1983, has continued.

Israel ran a substantial civilian current account surplus in 1985 due to continued improvement in its balance of trade and substantial increase in transfers from abroad. This improvement resulted in more than a billion-dollar increase in official reserves, from the mid-year low point, to about $3.2 billion at year's end. Israel's foreign debt stabilized and its maturity structure improved, as short-term debt was repaid during 1985. U.S. economic support funds and disbursements from our FY 85 supplemental appropriation for Israel made an important contribution. The remainder of our supplemental, which was a one-time emergency assistance measure, will be disbursed in FY 86 in support of further Israeli reform efforts.

Notwithstanding the considerable progress made so far, Israel's stabilization program remains fragile. The major challenge will continue to be maintaining control over government spending. The new Israeli budget moves in the right direction, but additional reductions in government spending may be necessary. Recent wage increases are also cause for concern. While real wages have fallen sharply since last July, they are programmed to increase in the December-March period; by April real wages will be where they were last June.

Unless offsetting measures are taken to contain the attendant increase in domestic demand and production costs, wage increases of this size could result in renewed inflation and higher unemployment. Future wage increases need to be linked to increases in labor productivity.

Over the longer term, the government of Israel will have to pursue reforms in a number of areas as a means of facilitating noninflationary growth. These include delinking financial assets from domestic price indices, labor market reform, and changes in investment and tax policies. Our recent bilateral discussions in the Joint Economic Development Group have focussed increasingly on these and other economic and investment issues in recognition of their importance to Israel's long term growth and prosperity. Our discussions with Israel in this forum underscore our commitment and partnership.

In the context of Israel's economic reform, we strongly endorse Operation Independence, a private sector effort to expand trade, encourage private investment, and reduce Israel's dependence on U.S. aid. Spearheaded by a group of dynamic American businessmen, this initiative has already produced tangible results in expanding Israel's exports.

Egyptian Economic Program

Last year, at the Administration's request, Congress also appropriated $500 million in supplemental assistance for Egypt. These funds, along with our regular assistance program, were in support of economic reform. In 1985, the Egyptian government drew up a 13-point reform program. It raised prices for agricultural commodities, for example, and for a wide range of sensitive consumer items; it also raised electricity rates by more than a third and gasoline prices by 25 percent. While these actions are a step in the right direction, they still fall far short of the comprehensive effort needed for long-term economic viability.

The remaining $150 million of the FY 1985 supplemental to support further reform measures will be appllied to priority areas for action, which include reducing the balance of payments and budget deficits, improving the system of debt management, and expanding the role of the private sector. Rapid progress in these areas is all the more urgent now, given the damaging impact on the Egyptian economy of the precipitous drop in oil prices.

## The Persian Gulf

We continue to be concerned and vigilant about the Persian Gulf. Strategically located, this region is vulnerable to Soviet expansionism. It remains a major source of energy supplies essential to the economic health of the free world. Our naval force in the Gulf expresses our interest in the security and stability of the region.

We and our Arab friends agree that they should be the first line of defense of the Gulf. Thus, our role -- an essential role -- is to continue reinforcing the defensive capabilities and security of Saudi Arabia and other friends in the Arab Peninsula, both through commercial sales and security assistance. The security relationship we have built with Oman is a vital element of our Central Command strategy. Our military assistance to the Yemen Arab Republic, on the other side of the peninsula, is particularly important in view of the recent destabilizing events in South Yemen.

We are deeply troubled by Iran's intransigent prolongation of its brutal war with Iraq, as well as by the dangers which this war poses for nearby neutral countries and the region as a whole.

We have urged all countries to withhold arms from Iran, and we have offered vigorous support for all the numerous efforts, particularly that of the United Nations, to bring the war to a negotiated end with the sovereignty and terroritorial integrity of both sides intact.

## Enhancing Defense and Security Relationships

Around the world, America's alliances and security relationships are sound. We have had some differences with our European allies during the past year. But alliances among free nations will always see expressions of differing perspectives. On the fundamental issues of our mutual security, the Atlantic Alliance remains solid. In fact, we made gains in the past year -- for example, in our bilateral discussions about participation in the research program of the Strategic Defense Initiative.

With the Soviet military threat to Central Europe and Southwest Asia continuing to grow, security assistance designed to improve the defense capabilities of countries on NATO's southern flank is of special importance.

Our security assistance to key NATO allies also helps ensure continued access to strategically important military bases and sustains confidence in the "best efforts" commitments which are the foundations of our base agreements.

We cannot measure our interests in NATO's southern flank solely by our military links. The broad common commitment to Western values has a meaning that transcends these military ties. Spain and Portugal have now joined Europe, in an important symbolic sense, in joining the European Community. This is a triumph for the Western world. On the other side of the Mediterranean, we often hear of problems bedeviling our bilateral relationships with Greece and Turkey. Let us not forget the common interests and shared values that underlie these relations and that establish the basis for the resolution of our difficulties. I view my upcoming trip to these two countries as part of the process of building on our common objectives.

On the other side of the globe, we continue to regard the U.S.-Japanese Mutual Security Treaty as the pillar of Asian peace and stability. Japan has become our largest market after Canada, and both sides are working toward resolving our trade differences.

We are also working with the Republic of Korea, whose security has never been more important to us, on trade issues and mutual security and resolving market access problems in our expanding two-way trade. While we have some serious problems with New Zealand, Australia remains a valued ally.

Our aid programs concentrate on the region's more threatened or vulnerable nations: the Philippines, the Republic of Korea, and Thailand.

We have just witnessed one of the most stirring examples of the democratic process in modern history. We honor the Filipino people and stand ready to assist the Philippines as the Government of President Aquino engages the problems of economic development and national security. We hope that the new Government will commit itself to implement many of the economic and military reforms which reform-minded Filipinos have been advocating for some time.

The levels requested for FY 87 still represent the Administration's request at this time. The full amount is certainly still required. We should fulfill the President's "best effort" commitment made in the context of the last five year review of the military bases agreement.

Continuation of our assistance under this commitment would now serve to underscore that it was a commitment made to the legitimate government of the Philippines, not just to the Marcos regime.

We are reviewing our aid program to see how it can be structured to respond to the neeeds and initiatives of the new Philippine Government. If our review shows that the aid requirements of the new Government of the Philippines exceed the amounts we have programmed, we will have to consider our options. If it becomes necessary after comsidering such options to change the level of our FY 87 request, or to make changes in FY 86, that would be communicated to the Congress, as quickly as possible, through our established process. We will certainly need the support of the Congress as the new Government engages the urgent economic and security problems it has inherited.

The Republic of Korea continues to confront the greatest threat to its security from its communist neighbor to the north. Tension on the peninsula remains high, and continued American presence and support are crucial, especially during the period up to the 1980 Seoul Olympics.

Our Korean ally is already devoting a large portion of its GNP to defense, but continued FMS credits are needed if Korea is to meet key objectives of its Force Improvement Plan.

Like Korea, Thailand is an ally allocating substantial resources to military modernization and creating a credible deterrent to Vietnamese aggression. We need to support these efforts and assist Thailand in achieving its development goals so that it can maintain a healthy, balanced economy in the face of its increasing security needs. We need to do this not only because of the importance of Thailand itself but because we have an enormous stake in the independence, prosperity and integrity of the group of ASEAN nations of which Thailand is a part. The ASEAN nations sit astride vital sea lanes joining Asia with the Middle East and Europe. The United States -- indeed most of the free nations of the world -- have a critical interest in keeping them peaceful and open. Our assistance programs in Malaysia, Singapore, and Indonesia help ensure stability and promote progress.

One very important element in our support for ASEAN is the effort to find a political solution in Cambodia. To this end, we are backing the non-communist Cambodian groups resisting Vietnam's occupation of their country.

Following the Vietnamese offensive a year ago that drove their camps away from the Thai-Cambodian border, these forces have concentrated on regrouping and training for guerrilla activity inside Cambodia.

Together, the Khmer People's National Liberation Force (KPNLF) and the Sihanoukist National Army (ANS) have some 9,000 troops currently operating inside the country, with more scheduled to enter. Despite problems that include a serious split within the KPNLF leadership, military-resistance leaders are optimistic about their prospects. We are now discussing with interested parties how the U.S. assistance funds for non-communist groups provided in FY 1986 can best support resistance activities. We do not plan to provide lethal equipment, as the groups are already adequately supplied with weapons.

In the Pacific, we are in the process of establishing a new and unique relationship with the Freely Associated States of Micronesia. In the South Pacific we are facing for the first time the threat of increased Soviet interest and activity. The negotiation of a regional fisheries agreement with the nations of the South Pacific which promotes US interests in the area. We hope to reach a final agreement later this year.

In South Asia, the Soviet aggression in Afghanistan has continued for more than six years. Pakistan's staunch opposition to Soviet aggression and its generosity to more than two million Afghan refugees pose an enormous financial burden on Pakistan, which the United States has tried to alleviate through our current six-year economic, five-year military program of assistance. This program enters its final year in FY-87. We must maintain that support, out of loyalty to a staunch ally that faces a direct Soviet threat, and to maintain the pressure on the Soviets to move toward a negotiated settlement in Afghanistan.

Our assistance provides vital support for Pakistan as that country enters a new era of democratization, which began with the lifting of martial law on December 30, 1985. The new civilian government is looking to the United States, which has strongly encouraged a more representative government, to provide continued moral and financial support as the government copes with the continuing Soviet aggression in Afghanistan and the burden of refugees. Pakistan is a poor country, and our assistance also helps it pursue its economic development plans even under the heavy burdens it bears.

We remain seriously concerned over the direction of the Pakistan nuclear program, and we have made it clear to the Pakistani government that our ability to continue our security assistance program presumes their restraint in the nuclear area. We believe our security assistance relationship contributes significantly to our non-proliferation efforts by enhancing Pakistan's sense of security and bolstering Pakisitan's conventional capabilities. Over time, we hope to persuade Pakistan that the pursuit of nuclear weapons capability is neither necessary, desirable, nor in its broader security interests.

## Regional Stability and Security in Central America and the Caribbean

Events in Central America and the Caribbean over the past year have confirmed the important link that exists between foreign assistance and U.S. national interests. Our continuing policy of support to pro-democratic forces is enabling democracy to take root and to become self-sustaining.

Guatemala is the latest Central American country to have abandoned military rule for elected civilian government. Elected civilian leaders also have replaced authoritarian regimes in El Salvador and Honduras.

Nicaragua is the only non-democratic country remaining in that region.

A few years ago, critics of Central America and U.S. policy toward that region were skeptical that democracy could gain support in an environment where history and economic hardship seemed to impose such burdens. They are less skeptical now. They have seen the people themselves, in one free vote after another, demonstrate their belief that democracy is the road to a better life for themselves and their children. They have also seen that our moral support and economic and security assistance can help make the difference between the success and failure of this democratic experiment. If we truly believe in human rights and economic and social progress, we must keep that lesson in mind as the peoples aspiring to freedom turn to us for support in the coming months.

The most immediate danger to democracy in Central America, of course, is the assault on it from Communist Nicaragua, aided by Cuba and the Soviet Union. Democratic El Salvador is an outstanding example of a country that has managed to withstand a communist insurgency, and we have been privileged to play a part by our encouragement and help. So our policy -- if we keep at it -- is working. All the democracies of Central America look to us for help in defending themselves.

We must support them. And we must support, not abandon, the democratic resistance within Nicaragua, which we support for both moral and strategic reasons. We will be discussing with the Congress what this moral and strategic imperative requires.

The Caribbean too is fertile ground for democracy. Cuba is the most egregious exception. In Haiti, after decades of autocratic government and a stagnating economy, the people have new hope of seeing a government responsive to their needs and aspirations. Our policy toward Haiti is the same as our policy toward the rest of the hemisphere. We seek to promote progress toward democracy, greater respect for human rights, and rapid and equitable economic growth. We feel that the Haitian people should choose their own future and we note that the new government has committed itself to this objective. We hope to be of help as the interim government goes forward with this effort.

On the economic side, the Caribbean Basin Initiative is succeeding in broadening and diversifying the production and export base of the region, laying the foundation for long-term recovery. Unfortunately, many of the gains have been offset by declines in the prices for traditional exports. In some cases, most notably sugar, the declines in prices are aggravated by our farm bill which will result in a loss of $52.0 million in export earnings by the Caribbean Basin countries.

The restructuring of economies to make them less vulnerable to commodity price fluctuations requires a sustained commitment from the political leadership of these countries. It also requires sustained support from the international development community. We will continue to do our share.

## Supporting Economic Reforms and Democratic Institutions

Looking beyond Central America and the Caribbean, across the globe, we see further evidence of the powerful appeal of liberty. Democracy is taking root in country after country, demonstrating the vitality and relevance of our ideals.

The past few years have also confirmed the connection between freedom and economic progress. In the early 1980's, this Administration developed economic policies aimed at liberating the creativity of the American people. The results speak for themselves: 9 million new jobs in this country in the last three years, helping pull the world economy out of recession, with inflation now one-third the rate of five years ago.

The world economy is still troubled. But nations everywhere are re-discovering the basic truth that the source of economic growth is individual creativity, not the state.

The same laws of economics apply to developed and developing countries alike, and those that apply its truths are reaping the rewards.

India, the world's largest democracy, is a critical -- and successful -- test case that shows that democratic politics and economic development are not only compatible, but mutually supportive. Under Rajiv Gandhi's able leadership, India is moving into an era of advanced technology and rapid economic growth, spurred on by the liberal economic policies. It is not only an increasingly attractive market for American exports, but is a major participant in the world economy in such areas as computer software and light industrial goods.

India has also assumed an increasingly important strategic role, as it takes its place as a major regional -- and world -- power. It has begun this process by improving its ties with its regional neighbors, including Pakistan. We welcome the improvement in our own relations with India that has taken place last year.

In Argentina, Brazil, Ecuador, Uruguay, Bolivia, and Peru, democratic governments are faced with the daunting challenge of restoring economic stability and establishing the conditions for sustained economic growth.

The task for the Andean countries is further complicated by narcotics trafficking and terrorism. In Colombia, one of the oldest democracies in South America, terrorists and narcotics traffickers are threatening to undermine years of economic growth and progress. We want to help Colombian efforts to meet these threats. To do so, we are seeking modest increases in our security assistance program.

In Peru, a ruthless terrorist organization and a well-entrenched narcotics industry threaten national stability. We applaud President Garcia's commitment to stamp out narcotics trafficking and his determination to end terrorism within the context of democracy and respect for human rights. A mutually constructive relationship with Peru, however, will require greater moderation and cooperation and meaningful economic reform by the Peruvian government. If these actions evolve as we hope, we would need to find increased resources to support the Peruvian effort.

In Africa, young and fragile governments are struggling with the most profound economic crisis in the continent's modern history. Our adversaries have shown themselves willing to take advantage of the continent's plight, exploiting political-military conditions in such disparate areas as southern Africa, Chad, and the Horn.

It is in our own interest to help Africa realize its potential: to fuel economic growth; to monitor and thwart the actions of Libya, the Soviets and their surrogates; and to encourage adherence to improving standards of human rights.

Last year, the world witnessed the devastating effects of the drought which put over thirty million Africans at risk of starvation. The American response was extraordinary. Our government and private sector contributions provided unprecedented levels of food, as much as the rest of the world combined. The combined effort saved countless lives and we can be justifiably proud of the results.

For the long term, we must encourage Africans themselves to promote the policies that lead to agricultural productivity, economic growth, and stability. There is cause for hope. Some African countries are starting to reject the statist economic policies which proved so disastrous, misallocating scarce resources and discouraging the productive private sectors of the economy.

Our bilateral AID programs are increasingly stressing policy reforms that stimulate private sector productivity. The African Economic Policy Reform Program (AEPRP) made good progress in 1985 in promoting market-oriented reforms in Malawi, Mali, Mauritius, Rwanda and Zambia.

This year, we plan to start implementing the President's Food for Progress initiative, which will concentrate on reforms in the agricultural sector needed to provide farmers with adequate incentives.

## Diplomacy in Southern and South Africa

Turning from purely economic to more general concerns, no region of Africa is the cause of more debate and concern, both in the United States and abroad, than southern Africa. We are committed to playing a positive role as the region grapples with the twin challenges of containing regional strife and bringing the abhorrent system of apartheid to an end.

In the regional conflict, our aim is to show that military solutions will not work. Unfortunately, the Soviet Union and its Cuban and Angolan allies still have illusions on this score. Over the last two years, the Soviets have delivered an extraordinary $2 billion in military equipment to the regime in Luanda, and have engaged themselves directly in the fighting. The visit of Jonas Savimbi to this country should make clear America's determination to ensure that no outside power will be allowed the opportunity to resolve, on the battlefield, the civil war that divides Angola. At the same time, we search for a negotiated solution.

As long as negotiations continue, the path lies open to a settlement which would lead to the independence of Namibia and end the intervention of all foreign military forces in Angola.

We are particularly pleased by Mozambique's substantial move toward genuine non-alignment. This is reinforced by major new aid commitments from the West, of which our own aid program is an integral part. We want to encourage this favorable trend. I am concerned that the Congressional restrictions on aid to Mozambique threaten to undo what has been a significant political accomplishment of U.S. foreign policy.

In South Africa, the goal of reform must be to end apartheid and to bring about a political system based on the consent of the governed. The President's Executive Order of last September 9 was designed to convey the united opposition of the American people to the apartheid system. This is a message we continually reiterate in contacts with the South African government. It is also a message we are sending in concrete ways, as we move to build ties with the black community in South Africa. The aid program mandated by the Executive Order works through private voluntary organizations to train black leaders for the future and to assist black entrepreneurs. We are also providing funds for direct legal assistance to the victims of apartheid and their families.

The Human Rights Fund will provide $1.5 million for these and similar projects while about $10 million will be available for scholarships for those disadvantaged by apartheid.

America continues to play a positive role in South Africa, but outside countries cannot, alone or in combination, resolve South Africa's problems. The government there must take the steps that will make it possible for black leaders to negotiate. In turn these leaders must be willing to negotiate themselves. The alternative is the kind of violent upheaval that seldom produces just or democratic solutions.

## Multilateral Development Banks and Programs

The Multilateral Development Banks play an important and complementary role in many countries important to the United States. As developing countries seek to move from crisis management and austerity to a renewal of sustained economic growth, they will be competing for a finite supply of investment capital from the international financial community. These resources will flow where they are welcome -- when conditions are hospitable.

A true partnership based on mutuality of interest will have to be forged between the developing countries and the holders of development capital -- the industrial countries, international lending institutions, and the commercial banks.

Last October, at the Bank-Fund meeting in Seoul, Secretary Baker proposed a bold, new comprehensive approach to get debtor countries back on the path of sustained growth. The proposal envisaged a more vigorous World Bank role in facilitating and promoting economic reform and adjustment in debtor nations, as well as greater coordination between the Bank and the IMF in their country programs. The proposal also included a provision for enhancing World Bank and IMF cooperation in providing concessional financing to the poorest developing countries, most of which are located in sub-Saharan Africa.

When Secretary Baker outlined our approach, he stressed that the sine qua non of any comprehensive strategy was a more focused and determined effort of market-oriented structural reform aimed at greater efficiency, more domestic saving, and a more attractive climate for domestic and foreign investment. And, in conjunction with this, he addressed two other key elements designed to provide outside support and encouragement for structural reform: more substantial and better-coordinated assistance from multilateral institutions, and more support from commercial banks.

This was a creative effort, it seems to me, to bring the broader international community into the process of helping solve the debt problem. Both the World Bank and regional development banks are well placed to complement the continued central role of the IMF by providing financing and advice to countries taking the essential steps toward structural reform. The World Bank's considerable expertise can help devise programs for growth through structural reform. It can support these programs through increased lending to promote reform in inefficient sectors of the economy, and through increases in policy-based lending. The Inter-American Development bank is uniquely situated to help in this effort, as well, but improvements are needed in its institutional capabilities before this potential can be fully realized. Our participation in the multilateral development banks is an integral part of our assistance policy. Continued Congressional support for our replenishment commitments will sustain our leadership role in these institutions.

The new commercial bank lending that Secretary Baker proposed -- $20 billion over a three-year period -- is also a vital part of the near-term effort. Bank lending to the principal debtor countries has been declining, with very little new net lending having taken place in 1985.

Increased lending can provide important support for policies to promote efficiency, competitiveness, and productivity -- the true foundations of growth. Such lending, however, will only be forthcoming if there is a clear commitment to adopt and implement such growth-oriented policies.

In Seoul, Secretary Baker also proposed that the World Bank, IMF, and other donors develop joint programs to support medium-term structural adjustment in the world's poorest countries. Africa will be the chief beneficiary. The proposal calls for the coordinated use of $2.7 billion in IMF Trust Fund reflows World Bank funds, IDA monies, and possible increases in bilateral contributions for Africa to support comprehensive economic reform programs. This proposal merits our full support as the development of consistent and coherent country economic reform programs is essential if we are to maximize the efficient use of scarce development capital.

The need for increased coordination between the Bank and Fund has been generally supported; and the U.S. initiative is gaining broad acceptance. We have addressed the concerns of Fund and Bank members regarding the need not to blur the distinctive roles of the two institutions while achieving closer cooperation and collaboration.

I do not want to leave the subject of efficient use of development capital without commenting on the need of the developing countries to take full advantage of the opportunities of the world trading system. This is essential if they are to achieve their great potential for expansion of output and export earnings.

Restrictive trade practices have only compounded the problems of many heavily-indebted developing countries. All too typically, heavy foreign borrowing has supported fiscal deficits and overvalued exchange rates, putting a great burden on export competitiveness. Import barriers have been erected to protect favored domestic industries from foreign competition. These barriers have severely hampered the growth of trade among developing nations. The developing countries and the industrialized world have one thing in common: all of our peoples are winners if we have a stronger and fairer world trading system. We hope the developing countries will work with us on a new trade round to overcome the narrow interests that threaten our common progress.

## Conclusion

In summary, Mr. Chairman, the world remains a turbulent and sometimes dangerous place. But as we look ahead, we draw strength from our ideals, from our friends and the young democratic nations who have joined our ranks and now look to us for support. America remains a beacon to the freedom-loving peoples of the world. Powerful trends are the side of freedom. That is one of the lessons of 1985.

Another major lesson of the recent past is that realism, strength, and staying power are crucial prerequisites to meeting these international challenges. History won't do our work for us. We have to be worthy of our opportunities.

The President has observed that the responsibility for the economic health of our country does not reside with one branch of our government nor with one political party. The partnerships that must be forged to deal with the federal budget deficit are also critical to meeting the challenges we face in the international arena, many of which directly affect our national security.

The noble tradition of bipartisanship, which brought us so many dividends in the postwar years, does not ask any of us to abandon our principles. But it does require all of us to recognize how much harder it is to meet foreign challenges if we are not united at home. In recent years, we have seen signs of a rebirth of the postwar national consensus -- based on a realistic understanding of the world as it is, and of the need to negotiate differences where possible. The President has asked me to reiterate his commitment to work in a bipartisan spirit with all members of the Congress on behalf of the peace, freedom, and security of this country.

## ECONOMIC POLICY

Mr. **Obey**. Thank you, Mr. Secretary.

Mr. Secretary, I didn't suggest in my statement that things domestically have gone to hell in a hand basket. What I suggested is that domestic discretionary programs have been cut in half. It is quite a different statement.

Secretary **Shultz**. It was probably a good thing. Let's face it, I think government ought to be able to get along on a trillion dollars a year.

Mr. **Obey**. So do I.

Secretary **Shultz**. It is a hell of a pile of money.

Mr. **Obey**. So do I. But, let's put that in perspective. Since you referred to the wonders of economic policy of the last five years, let me point out—if you want to use some of those measurements—you asked me when was the last time we had similar job growth in this economy.

The fact is that when you cite 10 million new jobs, you are forgetting the 3½ million jobs lost during the recession the first two years of the Administration, which means there was a net job growth under this Administration of 6½ million jobs, which is the slowest job growth rate that we have had since the early Sixties.

The productivity——

Secretary **Shultz**. I would challenge that number. We will get the reports out.

Mr. **Obey**. We will both put numbers in the record.

We have zero growth in productivity the last quarter. We have real interest rates 3 percent above historical averages. We have personal savings rates at the lowest point in 35 years. We have a lot of problems.

But that was not my point. My point was, how are we going to pass a foreign aid bill this year? My point is simple: That when we are being asked to reduce domestic programs by the numbers that we are being asked to reduce them, whether it is cancer research or student loans, you name it, the House is simply not going to support a $2 billion increase in this bill in the light of those reductions. And we can argue about whether they should or not, but the fact is they are not going to.

The numbers which you cited in the budget were numbers for the entire function. But the numbers under the jurisdiction of this committee, foregoing for the moment any discussion of Ex-Im which, as I indicated, is not foreign aid—it is export subsidy—we had in 1981 $6.377 billion for the rest of the programs under the jurisdiction of this committee. In 1985, that had grown to $14.5 billion. In 1986, it had grown to—shrunk to $13.3 billion from that high of 1985. And in the fiscal year 1987 budget, you are asking for $15.475 billion for non-Ex-Im items, which is a $2.1 billion increase over last year for those items under the jurisdiction of this subcommittee.

I doubt that we are going to think that it is as essential to provide a new grant MAP program to Burma as the Congress is going to think that it is essential to salvage the cancer research budget, which the President's budget cuts by $68 million.

## DRUG INTERDICTION

Secretary SHULTZ. Let's just take the Burma situation. I have the impression that people in the Congress are very much interested in the drug problem, in doing something about it.

Mr. OBEY. What are we cutting our drug interdiction programs by here at home, however?

Secretary SHULTZ. Both here at home and abroad.

Our ability to develop an interaction with Burma is a part of that effort, so there is a substantive element here.

I would say as far as here at home is concerned, having worked on this drug problem now for—in government, going back to 1969 and 1970—there is more of a lift right now, and personally I give the First Lady, Nancy Reagan, an awful lot of credit for really dramatizing what is going on and what we need to do.

I know we have no difference of opinion here at all on the importance of dealing with this problem. But I flagged this because you mentioned Burma sort of like a faraway place, who is interested in that. I think you have to come right down close in and say, well, what is that all about? And there is a relationship to things that we care about a great deal in this country.

Mr. OBEY. Mr. Secretary, you bet there is. If you want to take a look at drug programs, this very same budget is requiring a reduction in drug interdiction programs right here domestically. I think that is going to be a problem.

Take a look at what is happening to law enforcement programs here at home. They are being squeezed under Gramm-Rudman and the President's budget. But we will see. We will see whose judgment prevails in terms of what the Congress will do.

## FOREIGN ASSISTANCE

Secretary SHULTZ. I am not here to make an estimate of what the Congress will do. I am not an expert on that subject; don't pretend to be. I would cede always to the Members on that.

I recognize we have to come in with things that make sense. What the President has tried to do here, what I have tried to do, is tell you what I think is in the interests of the United States and to say that is my job. I have to stick to that within the constraints of what is reasonable.

Now, as far as the money under the jurisdiction of the committee, I think—I gather it is the 151 and 152 account. In my tabulation, the 1985 actual was $13.735 billion. I am sorry, that was security assistance. Total foreign assistance under these two accounts was $20.2 billion, according to this chart I have here.

Mr. OBEY. I think what you are looking at includes the functions that are dealt with by the State, Justice, Commerce Committee, as well.

Secretary SHULTZ. No, sir. That would be—153, 151 and 152 are the ones I am talking about.

Mr. OBEY. Mr. Secretary, again why don't you put your chart in the record. I will put my chart in the record.

The fact is, what you are asking this subcommittee to approve this year is $2.1 billion above last year's level if you exclude requests for the Export-Import Bank, which we regard as being export subsidies rather than foreign assistance programs.

# FOREIGN OPERATIONS AND RELATED PROGRAMS

## Committee Chart

### Summary

| | FY 1981 Enacted | FY 1986 Adjusted (GRH) | Proposed FY 86 Resc & Supplementals | FY 1987 Request | FY 1987 compared with FY 1981 | FY 1987 compared with FY 1986 adjusted |
|---|---|---|---|---|---|---|
| Military Assistance Programs: | | | | | | |
| Military Assistance | 110,200,000 | 748,374,000 | --- | 996,450,000 | +886,250,000 | +248,076,000 |
| International Military Education and Training | 28,400,000 | 52,146,500 | --- | 68,830,000 | +40,430,000 | +16,683,500 |
| Foreign Military Credit Sales: | | | | | | |
| Direct credits and forgiven loans | 500,000,000 | 4,966,830,000 | --- | 5,661,000,000 | +5,161,000,000 | +694,170,000 |
| Loan guarantees | (2,546,187,000) | --- | --- | --- | (-2,546,187,000) | --- |
| Total, military assistance programs | 638,600,000 | 5,767,350,500 | --- | 6,726,280,000 | +6,087,680,000 | +958,929,500 |
| Adjusted total, MAP (including loan guarantees). | (3,184,787,000) | (5,767,350,500) | --- | (6,726,280,000) | (+3,541,493,000) | (+958,929,500) |
| Economic Support Fund | 2,104,500,000 | 3,540,642,000 | --- | 4,093,800,000 | +1,989,300,000 | +553,158,000 |
| Development Assistance: | | | | | | |
| International organizations and programs | 262,380,000 | 265,971,475 | -51,711,475 | 186,000,000 | -76,380,000 | -79,971,475 |
| Bilateral Development Assistance | 2,367,639,500 | 2,584,208,000 | 54,840,000 | 2,758,412,000 | +390,812,500 | +174,244,000 |
| Subtotal, non-bank development assistance | 2,630,019,500 | 2,850,179,475 | 3,128,525 | 2,944,412,000 | +314,432,500 | +94,272,525 |
| International Financial Institutions | 1,003,600,944 | 1,142,512,240 | --- | 1,392,002,125 | +388,401,181 | +249,489,885 |
| Total, development assistance | 3,633,620,444 | 3,992,691,715 | 3,128,525 | 4,336,414,125 | +702,833,681 | +343,762,410 |
| Total, Budget authority, titles I, II & III | 6,376,720,444 | 13,300,684,215 | 3,128,525 | 15,156,514,125 | +8,779,813,681 | +1,855,849,910 |
| Export assistance: | | | | | | |
| Budget authority effect of Ex-Im limitations | 6,613,000,000 | 1,062,270,000 | --- | --- | -6,613,000,000 | -1,062,270,000 |
| Other | --- | 18,087,000 | --- | 318,000,000 | +318,000,000 | +299,913,000 |
| Total, export assistance | 6,613,000,000 | 1,080,357,000 | --- | 318,000,000 | -6,295,000,000 | -762,357,000 |
| Total, Budget authority (excluding Ex-Im) | 6,376,720,444 | 13,318,771,215 | 3,128,525 | 15,474,514,125 | +9,097,813,681 | +2,155,762,910 |
| Total, Budget authority (including Ex-Im) | 12,989,720,444 | 14,381,041,215 | 3,128,525 | 15,474,514,125 | +2,484,813,681 | +1,093,492,910 |

BUDGET FUNCTION 150

(MILLIONS OF DOLLARS)

State Department Chart

| | 1985 ACTUAL | 1986 REQUEST | 1986 APPROP. | 1986 SEQUES. | 1986 POST SEQ. | 1986 SUPPS. ETC. | 1986 86 IN 87 BUD. | 1987 REQ. |
|---|---|---|---|---|---|---|---|---|
| 151—International Development and humanitarian asst. | 6,496 | 5,351 | 4,885 | (232) | 4,653 | 19 | 4,672 | 4,893 |
| 152—International security assistance | 13,731 | 11,638 | 10,656 | (420) | 10,236 | 5 | 10,241 | 11,273 |
| Sub-total-- Foreign Assist. | 20,227 | 16,989 | 15,541 | (652) | 14,889 | 24 | 14,913 | 16,166 |
| 153—Conduct of foreign affairs | 2,510 | 2,488 | 2,397 | (103) | 2,294 | 702 | 2,996 | 3,830 |
| 154—Foreign information and exchange activities | 940 | 1,127 | 980 | (42) | 938 | 32 | 970 | 1,129 |
| 155--International financial programs | 2,776 | 2,213 | 2,360 | -- | 2,360 | (447)* | 1,913 | 1,511 |
| Total Function 150 | 26,453 | 22,817 | 21,278 | (797) | 20,481 | 311 | 20,792 | 22,636 |

* Technical Adjustment

NOTE: Above figures only include Function 150 activities. Not included are State Department activities included in other functions (e.g., Micronesia Compact, Foreign Service Retirement and Disability Fund).

Secretary SHULTZ. We are really not in disagreement.

Mr. OBEY. That is right.

Secretary SHULTZ. These are facts. You are putting your emphasis on where our request is as compared with what the Congress did last year. And I am putting my emphasis on what our request is as compared with what we requested last year to show that from our standpoint we have skinnied this thing down a lot and we continue to believe that the requests are in the interests of the United States.

Mr. OBEY. Mr. Secretary, when I go to pay my bills, I don't pay those bills with money I wish I had earned this month. I pay those bills with money that I did earn this month.

You can't come to us and describe—you can, but I don't think it is accurate—describe your budget as being a skinny budget if it contains the kind of increases you have in this budget.

Secretary SHULTZ. I can't pay my bills out of money I don't have.

On the other hand, if I try to pay my bills and I see that there are some things I really should have done, then I have to go out and see if I can't find myself some more resources so I can face up to that in the future. That is exactly what I am doing here.

Mr. OBEY. That is exactly what I urge you to urge the President to do.

Secretary SHULTZ. I have talked to the President a lot. This represents his allocation. His allocation does not include a tax increase, which apparently is the main object of this discussion.

Mr. OBEY. The main object of this is to simply point out that we can't produce support for a bill if we can't pay for it.

### CONTRA AID

Mr. Secretary, let me ask you a specific question, because I know a lot of people are concerned about it.

The Administration is asking the Congress to approve $100 million in military, and other assistance, for Nicaragua, to the Contras in Nicaragua. This is on top of the $1.3 billion you are asking for all of Central America for fiscal year 1987. It is on top of the $4.7 billion the United States has spent in Central America in foreign aid since the President came to office.

And I share the goals, and I am sure the committee shares the goals of that request, because the Administration has justified that request by saying that the purpose of assistance to the Contras is to pressure the Sandinistas to change their internal policies. I would like to do that, too.

I much prefer the leadership of the Contras to the leadership of Nicaragua. As I indicated to you, I think last year, I consider Mr. Callero one of the three Contra members to be a good friend of mine, and I consider him to be a good man.

That is really not the question. The question is not whether I like Mr. Callero better than I like somebody sitting in the government seat in Nicaragua. The question is whether or not the tactics which the Administration wants to apply will really result in the ends which the Administration says they are trying to achieve.

There are a lot of us who care just as much about this country as the President does. We simply feel that we doubt that your goals are doable, given what you are asking us to provide to support those goals.

I think it is the judgment of many that the $100 million package which you are asking for in support to the Contras is enough to keep a bloody civil war going, but not enough to actually put sufficient pressure on the Contras to change their ways or to do some of the things we would like to see done internationally or domestically.

So, I think we view the military aid to the Contras, at least those of us who are dubious about the Administration's request—we view that assistance package not as a way to avoid American involvement down the line, but we are concerned that it, in fact, is going to put us on a slippery slope to involvement.

What I do not understand is how the goals which you lay out are, in fact, producible by the tactics you suggest. I doubt very much that a complete overthrow of the Sandinistas is likely to happen without massive intervention by us or without much more massive resources than you are talking about providing to the Contras.

I doubt very much that a collapse of political and economic structure in that country is likely without a much higher level of pressure and intervention than $100 million is going to provide.

I know that the President says he wants the Sandinistas to cry uncle, but many of us view the Sandinistas as being so fanatic and so overzealous that rather than change their ways, they will simply, if necessary, fade into the hills and keep up their revolutionary struggle, or whatever they want to call it.

Our concern, Mr. Secretary, is that—I will tell you what my concern is. My concern is the Administration has been drawing an analogy with the Philippines. I would like to draw my own analogy with the Philippines.

I really believe that if we were to draw the correct lesson from the Philippines in terms of how we are going to apply it to Central America, taking up the Administration's suggestion, I think we ought to point out that we didn't win in the Philippines by giving Mrs. Aquino $100 million in military aid. The Administration said, and the President correctly said, we had to let the people on the ground in the Philippines do it themselves.

If you take a look at Mr. Enrile's comments in this morning's paper, he said, "We did not want the Americans to get involved more than they did because we did not want to create the impression that this was an American-sponsored event, which was not the case."

It seems to me, Mr. Secretary, that if we were to truly take the lesson we need to take out of the Philippines, that we wouldn't be giving $100 million to the Contras. We would be trying to support the efforts of the countries in the region to achieve a negotiated solution by more than simply giving lip service to those efforts. It would seem to me that we would be listening to the new President of Costa Rica, who said last week, "If I were Mr. Reagan, I would give that money to Guatemala, El Salvador, Honduras and Costa Rica for economic aid, and not military aid to the Contras.

**I don't think that aid is going to achieve what he wants. On the contrary, the result with the aid to the Contras has been a more dictatorial, more totalitarian**

government in the north. They abolished the liberties, the individual liberties, because they have an excuse. The aid of the U.S. Congress to the Contras won't lead to a more open society in Nicaragua; you won't get a negotiation with the anti-Sandinistas by giving more money to the Contras.

Mr. Secretary, it just seems to me that if the Administration really believes that there is an analogy from the Philippines which can be drawn and applied to Nicaragua, that they are drawing the wrong analogy, taking the wrong lesson, and applying it to the wrong place.

I invite your response. I apologize to the committee members. I have taken far too much time.

Secretary SHULTZ. Thank you, Mr. Chairman. I appreciate your invitation to speak on this subject.

Let me first agree with you. I think what you said was that the Contras are the good guys and the Nicaraguan communist government is the bad guys. So, we are on the side of the good guys here.

Mr. OBEY. Mr. Secretary, I would say that some of the Contras are the good guys. I wouldn't necessarily ascribe that to all of them. I would say that people like Mr. Callero are definitely decent people.

Secretary SHULTZ. Earlier we both agreed that people who engage in drug trafficking are bad guys, and there is irrefutable proof that the Nicaraguan communist government engages in that activity.

We haven't talked about terrorism, but I assume that you would—in fact, I know that you think that terrorism is a bad thing in this world and would have nothing good to say about the M–19 attack on the Palace of Justice in Colombia which was carried out against justices who were acting on the case of drug traffickers, and in which weaponry that emanated from Nicaragua was used. So, I know you would be against that.

I am sure you don't like to see a government in a region like Central America actively engaged in subverting its neighbors, sending armaments around and training people.

I don't follow exactly your notion of let the people on the ground fight it out if what that means is that any time we find an intransigent group that gets into power and gets a half a billion dollars of support from the Soviet Union and its satellites over the last five years and those who are fighting for more decent ends don't get any support.

I think on the question of build-up, there is a very interesting juxtaposition in that all of our assistance to the Contras ended in the middle of 1984. Subsequently, the high-powered attack helicopters started being introduced by the Soviet Union. They saw a vacuum, and they moved into it. It isn't exactly an argument that what we did—or maybe it is an argument that what we did stimulated what the Soviets did, but not the argument that is usually made.

When they see that we don't stand up to a problem, that is just the occasion when they move in. So that is what we are seeing there.

I think we can all be reasonably proud of developments in Central America over the past four or five years. Our policies have worked. We see democratically-based governments in all the countries down there. We see increasing attention to the rule of law. We see some prospect of widely shared economic development.

We can get away from the military conflict engendered by what is going on in Nicaragua. In other words, things are going pretty well except in Nicaragua, where—no one argues—you have a Soviet-Cuban supported government trying—although it has not succeeded yet—to turn that country into a totalitarian style of state.

We think we have a big stake in preventing that. And the way to work at that is, of course, to support the countries in the neighborhood, help them flourish; but also to support those in the country who are willing to fight for the freedom and independence of their country. That is what the President's proposal is designed to do.

I feel personally very strongly that we should at least do that much. I am glad to hear that if you are on one side or the other of the issue, we think we should be doing more, not less.

I also think that if your concern—that is, you questioned whether it was enough. Maybe you think we should do more. I don't want to put words into your mouth exactly. I see you are smiling. I think if it is a question of avoiding the use of U.S. military forces directly, all of the arguments favor the course the President is taking. If you say do they have a chance of winning, certainly they have a chance of winning in the sense of being part of a process that makes a basic change in the way Nicaragua is governed and the way Nicaragua conducts itself in its neighborhood.

Maybe eventually they will have a chance of actually winning, if it comes to that. And you spoke about the members of the present government being in the hills. Well, I would much rather have them being in the hills than being in Managua with the kind of power that they are accumulating.

The fact of the matter is that the people we are wanting to support have their forces come to them; people come to them voluntarily. The people that we are opposing have to coerce people into their armed force. So there is a message there about what side the people are on.

And I think lessons from the Philippines—let's not overdo it. Certainly, one of the lessons from the Philippines is that somehow or other in the end, if they have a chance, the will of the people will prevail. I think that where the will of the people is in Nicaragua is reasonably clear.

So I am an all-out supporter of what the President is trying to do. I think it is very much in our interests, very much in the interests of Central America and Latin America generally.

Whether we are talking about our interests in security in our neighborhood, whether we are talking about the problem of dealing with flows of refugees, whether we are talking about our concern about terrorism, whether we are talking about our concern about drug trafficking, it is an unambiguous picture. So, it seems to me that the President's request for support is, if anything, on the low side.

Mr. **Mrazek**. Mr. Chairman, will you yield for a brief question?

Mr. **Obey**. Bob, I would rather not. I have already taken too much time. I would like to pass the witness.

I would simply say, Mr. Secretary, your response essentially told us they are bad people, they are doing bad things. We all agree with that.

The question isn't whether they are bad people doing bad things. The question is whether the policies that you are recommending are the policies which will actually do something about it; or whether they are just the first step in taking us into deeper involvement. That is what we are talking about, not whether they are doing nasty things which we are all against.

Mr. Kemp.

Mr. **Kemp**. Thank you, Mr. Chairman.

I apologize for being late. We were in a Budget Committee meeting, and I had to be there briefly.

I did want to get back, Mr. Secretary, to welcome you before this committee and to tell you that I will look forward to supporting the President's foreign aid request.

I think Mr. Edwards might have alluded earlier to the fact that it is not likely that the full request will get approved by this committee, as even the Chairman pointed out last year. But, in my view, foreign assistance, both multilateral and bilateral, is an integral part of our nation's defense policy, and indeed our nation's foreign policy. And, as you pointed out, in the world today the United States is well respected.

We are called upon to be at the center of gravity of almost every negotiation going on anywhere in the world. That shows in part the relevance of the United States with regard to the key issues facing this world.

As President Kennedy mentioned in the early 1960s, we are independent while at the same time recognizing the interdependence of the United States and the whole free world, if not the world itself.

So I, as one, want to view this budget request that you have made in context. In my view there is no way you can devise some pure formula around which foreign aid can be administered. We have to look at our priorities. We have to look at the threat that we face. We, indeed, have to look at those objectives that you outlined: freedom, democracy, a more just world; and our role in resolving some of those conflicts that the United States has had some success recently, both in Haiti and the Philippines.

So I want to say that as for one Member only, speaking only for myself right now, not even all my colleagues on the Minority side, I am going to support the request of the President. It is not an easy time to do so given the budget priorities. They have been, in my view, overaddressed; but nonetheless, I would like to tell you that I feel very confident that if we can move forward in fiscal year 1987 with the type of security assistance and economic development assistance programs proposed by the President, it will be to the benefit of the American people and help advance those objectives that are so important to ourselves and to the world.

Last year, the Republican Members of the Foreign Aid Appropriations Subcommittee were deeply concerned about some of the austerity practices of the multilateral development agencies. I was very pleased that you, Secretary Baker, and the President have all reaffirmed and acknowledged that in this world of international debt, particularly Latin American debt, growth is essential to paying off that debt.

I particularly look forward to being of assistance to the State Department and AID in attempting to devise those growth policies for the developing world so critical not only to the peace and security of the world, but also to our own economic conditions.

Forty-three percent of all U.S. exports go to Third World countries. We have a big stake in what happens in Central America, Latin America, Africa, Asia.

Finally, what you have been addressing this morning is critical to the security of our own nation. And there is another dimension here. It seems to me that we really as a country would have trouble, not just from a securitiy standpoint but from the perspective of living with our own conscience, if we were not on the side of the democratizing of Nicaragua at a time which we have had a key role in helping to bring democracy to the Philippines.

I think it is absolutely essential that assistance along the lines that you and the President have talked about go forward in 1986/1987. I think you will find that if you and the President and others who believe in this program continue to support it as eloquently as you have here today, and in previous statements that I have heard, that Congress will begin to realize that it has a big stake in supporting freedom not only in Nicaragua but throughout the world.

So, I thank you for being here today.

I thank the Chairman for giving me a few moments to at least express my comments generally.

I would, frankly, put a footnote on all of this and say it wasn't so long ago that U.S. foreign policy was a basket case. The Soviet Union, in the 1970s, was actually bragging around the world that the correlation of forces was on the side of Soviet Union style socialism, in the Third World particularly.

As you pointed out, freedom-loving men and women are all over the world rising up, taking heart from the fact that the United States is demonstrably interested in supporting them, both morally and materially. I just hope that our commitment will be not merely to continue to support them, but eventually to see them succeed.

I would like to ask, in the brief time that I have, about the Philippines. What is your view with regard to what we can immediately do to signal the Philippines Government, the Aquino Government, that we want to open up trade possibilities, that we want to assist their security and economic development needs, that we want to help build up the democratic process and the democratic capitalistic institutions in the Philippines, as we have tried to do and should be doing in Central America, particularly in El Salvador?

Secretary Shultz. Thank you very much for your comments.

First, let me say that I appreciate them, their eloquence, their clarity. I think you have always seen the importance of security and of economic growth and the relationship between those two objectives.

Your statement today reaffirms and underlines and puts an exclamation point there. As long as I have known you, which is quite a while, you have always pointed to growth as the key. I think you are absolutely right about that. I hope that that is what we will see more and more as a way around the debt problem, among other things.

Insofar as the Philippines is concerned, we are on the one hand doing our own homework very carefully, and on the other we have, in addition to our mission and Ambassador Bosworth, the President has dispatched General Phil Habib, who is in the Philippines right now. As you know, Phil went out earlier, and I think was extremely helpful to us in managing the events of a week before last, I guess it was, and then has returned. And he is talking with all of the members of the new government now, getting a sense of how they see it. And he will be back here very shortly. We want to consult very carefully with Phil.

Because I think one of the key points here is that what happened in the Philippines was primarily something done by the people of the Philippines. We want to come forward with something that helps them move along lines that they think are sensible rather than get up a U.S. program and take it out there and say, here, this is what we think you should do.

There is plenty of room for us to give our thoughts and advice, which we do. But our initial appraisal of the way they are going about the professionalization of their military is positive. Our initial discussions with the new Minister of Finance and the economic team there show a readiness to work along sensible directions and, at the same time, they can recognize and we recognize that they need help.

What I would counsel is that we accumulate information, that we get a good sense of their desired direction, and then we adapt what we do to what seems to make sense under those circumstances.

I don't think it is a good idea right now to make an announcement of, say, some big, new aid program or something like that. On the other hand, I think we want to make it clear to them that we are supporting them and we intend to be helpful and we can be helpful, and that may do a lot more for them in and of itself.

It is interesting to see what has happened to the peso. It has recovered. I think as financial markets see that that situation can be worked with—difficult as it is—and that there is a strong U.S. line of support, it tends to give people confidence. It is that kind of tone that we want to set.

I think the President is going to be sending Mr. McPherson out there very shortly. I don't know if your bags are packed or not Peter.

Mr. McPHERSON. Ready.

Secretary SHULTZ. He will take a good look.

Mr. KEMP. Mr. Secretary, thank you for your comments.

One question would revolve around Mr. McPherson's trip out there. I would be particularly interested in what the IMF is telling the Philippines to do, what they told them in 1985 and what they are telling them today.

I was disturbed—I don't want to repeat a private conversation, but you and I were with Mr. Habib when he said the Philippines has not lived up to an IMF agreement. What is the IMF telling the Philippines to do?

Before they told them to devalue the peso and reduce their budget deficit with taxes. That deficit, as a percentage of the economy, is lower than ours.

I would like to know—and I would like to formally request this committee find out—what is the IMF telling the Philippines to do. I think we need more information about some of their policies.

If you could get me that information, I think many of us on this committee would appreciate it. I am worried about it.

[The information follows:]

The IMF approved an 18-month standby program for the Phlippines in December 1984. The program sets a variety of quantitative performance criteria for fiscal and monetary policy. It also makes provision for reducing structural impediments to economic growth and development.

The overall goal of the program is to lay the foundation for sustainable, non-inflationary growth. Within this context, the specific objectives are: (1) to reduce the external current deficit to sustainable levels; (2) to achieve a prompt and enduring reduction in the inflation rate; and (3) to address long-standing weaknesses in the structure and management of the economic system.

Since the inception of the program: the inflation rate has fallen from a peak of 64 percent in late 1984 to about 4 percent in early 1986; interest rates are also down but remain highly positive; the current account deficit has narrowed dramatically; and overall balance of payments position has shown a sharp improvement.

### ECONOMIC DEVELOPMENT IN ASIA AND THE PACIFIC

Secretary **SHULTZ**. I think your question points up a very important aspect of how to work at this. The IMF is a big player. The World Bank is a big player. The Asian Bank can no doubt swing in here. Other countries are important in the picture. The flow of assistance from Japan exceeds that from the United States, for example.

We were able to consult with Japan on all of this. I think there is every reason to believe that we can coordinate flows with them.

Personally, I think given Japan's proportionate support for defense spending, they can afford to put forward some good economic support here. So we want to coordinate these things together and give a full, broad picture, not just what the U.S. is ready for.

Mr. **KEMP**. I agree with the role of Japan in helping sponsor or encourage economic development in those Asian and Pacific Nations—and they are even doing helpful things in the Central American region—which brings up my last question. I thank the Chairman for his patience.

### FOREIGN ASSISTANCE REQUEST

I mentioned earlier my general support for President's the request without tying it to one figure or another. Knowing the realities of the budget process alluded to by the Chairman and my colleague, Mickey Edwards, why would we, or the State Department, I should say, be requesting so much more for sub-Saharan Africa than for our own hemisphere?

With all due respect, I have supported both multilateral and bilateral assistance to Africa. I believe that is important to our future. In fact, I hope some day we have an African initiative not unlike our Caribbean Basin Initiative.

Mr. McPherson and I have discussed this. There is three times as much money requested for sub-Saharan Africa as for all of South America.

You are talking about the threat in Central America, the Isthmus; everyone knows the problems in Mexico. Why, in the State Department request, are we giving money to Mozambique and three times as much money for sub-Saharan Africa as for all the security and development assistance for our own hemisphere, which is critical to our strategic interests?

Secretary **Shultz**. First, let me say this is not the State Department's request. This is the President's request. This budget has been worked over by all of the people working with the President, and it is the President's budget.

Second, if you take all of our hemisphere, we don't send aid to Canada, unless you want to call our big trade deficit with Canada "assistance." We have a program with Mexico that is not an aid-related type program. They have serious financial problems and we are working with them to figure out how we can be helpful. But that is a different category of problem.

Most of the countries of South America—let's say Venezuela, Brazil, Argentina—we work with those countries. They have serious problems. They are working out of them, I believe.

Central America is special and we have made a very special effort in Central America. If you look at that, there is a fairly substantial flow.

Now, as far as sub-Saharan Africa is concerned, it is an exceedingly poor area. I am being told to shut up until I read this.

If you look at their per capita income, and if you look at their needs, particularly in agriculture, I think you can see why it is that we would want to put assistance there. According to my quick scribe, all of ARA—in other words, South America—Central and South America is $2.02 billion, and all of Africa is $1.18 billion. But you may have some different comparisons in mind.

Do you want to comment, Peter?

Mr. **McPherson**. The comparison that was made recently was between South America, excluding Central America, and sub-Saharan Africa. Those figures are what you indicated. But, again, it excludes Central America.

When you look at South America, we give a minimal amount of aid to countries outside the Andean region. What you have left is, fundamentally, the Andes. So, it is in the comparison of the Andes with all of sub-Saharan Africa that those figures come out. And, in that case, indeed, you do have roughly three times as much assistance in Africa as you do to the Andes.

I might note that the Andes figures have been substantially increased over the last couple of years because we have been very pleased with what has happened in Ecuador, for example.

### AFRICA

Mr. **Kemp**. That still doesn't answer the part about Mozambique, Ghana, and Zimbabwe.

Secretary SHULTZ. Mozambique—first of all, southern Africa is a troubled region. We have been working very hard on it in our diplomacy with some success.

In the case of Mozambique, the in-comity accord with South Africa was an important marker, even though you can point to that accord and wonder if the South Africans in particular are keeping their side of the bargain fully, where we know they aren't. At any rate, it still has helped there.

We see in Mozambique a country that has been very strongly in the Soviet camp and which we think is showing signs of moving into a more neutral position. We believe that is worth encouraging, particularly when the manner in which we provide encouragement goes to the private sector of Mozambique and encourages the kind of change in the management of agriculture that looks at the market and looks at incentives, all of the kinds of things you have always emphasized in economic development.

People in Mozambique and elsewhere can take a look at what happens when you adopt that form of organization of economic activity as compared with the form that they had been using and use in other parts of the economy. So we think it is part of a good investment in our effort to encourage change in a direction we think is desirable in that part of the world.

Mr. OBEY. Mr. McHugh.

Mr. MCHUGH. Thank you, Mr. Secretary, for being with us again today. We appreciate the difficulties and the importance of your job, and our responsibility to cooperate with you as much as we can.

First of all, before we leave the Africa-Central America comparison, I have figures in front of me which I think are relevant and probably could be instructive for the record. I think you and Mr. McPherson have responded appropriately to Mr. Kemp in terms of the importance of Africa and the economic problems Africa faces.

The figures indicate that, in fiscal year 1981, our bilateral economic assistance to Central America totaled about $231.7 million. At the same time, in sub-Saharan Africa, we were devoting a total of $649.4 million to bilateral economic aid.

The estimate for this fiscal year, 1986, is that we will be spending $821 million, up from $231.7 million, in Central America. In sub-Saharan Africa, we will have gone from $649.4 million to $823.8 million. So, the relative emphasis between 1981 and 1986 has shifted from Africa to Central America.

[The information follows:]

TABLE I.—U.S. ECONOMIC ASSISTANCE TO CENTRAL AMERICA AND SUB-SAHARAN AFRICA FISCAL YEAR 1986 COMPARED TO FISCAL YEAR 1981 [1]

| Fiscal year | Central America | Sub-Saharan Afric |
|---|---|---|
| 1981 actual | $231,721,000 | $649,427,000 |
| Development aid | 99,224,000 | 300,295,000 |
| Peace Corps | 7,123,000 | 38,761,000 |
| Economic Support Fund | 102,374,000 | 162,971,000 |
| Public Law title I | 23,000,000 | 147,400,000 |
| 1986 estimate | 821,029,000 | 823,766,000 |

### TABLE I.—U.S. ECONOMIC ASSISTANCE TO CENTRAL AMERICA AND SUB-SAHARAN AFRICA FISCAL YEAR 1986 COMPARED TO FISCAL YEAR 1981 [1]—Continued

| Fiscal year | Central America | Sub-Saharan Afric |
|---|---|---|
| Development aid | 243,044,000 | 336,781,000 |
| Peace Corps | 13,926,000 | 46,183,000 |
| Economic Support Fund | 466,059,000 | 288,702,000 |
| Public Law 480, title I | 98,000,000 | 152,100,000 |

[1] Data Source: Agency for International Development Congressional Presentation Documents. Development assistance for Africa includes Sahel Development Program. ESF assistance for Africa includes funding for the Economic Policy Initiative for Africa. Funding for Nicaragua is included in the fiscal year 1981 base for Central America although no funding will be provided to Nicaragua in fiscal year 1986. Please note that P.L. 480 Title I is included, and P.L. 480 Title II is excluded, from this table at the specific request of the Agency for International Development although neither is funded in the foreign aid appropriations bill.

### TABLE II.—U.S. ECONOMIC ASSISTANCE TO CENTRAL AMERICA AND SUB-SAHARAN AFRICA, FISCAL YEAR 1986 COMPARED TO FISCAL YEAR 1981, PERCENT INCREASE IN NOMINAL AND REAL TERMS [1]

| Program | Cental America | | Sub-Saharan Africa | |
|---|---|---|---|---|
| | Nominal | Real | Nominal | Real |
| Developmnent aid | 144.9 | 96.9 | 12.1 | −9.8 |
| Peace Corps | 95.5 | 57.2 | 19.1 | −4.2 |
| Economic Support Fund | 355.3 | 266.0 | 77.1 | 42.4 |
| Public Law 480, title I | 326.1 | 242.6 | 3.2 | −17.0 |
| Total | 254.3 | 184.9 | 26.8 | 2.0 |

[1] Calculations of positive and negative real growth are derived from conversion tables provided in the Security Assistance Congressional Presentation Document for fiscal year 1987.

Mr. McHugh. Now, I realize that there are many questions involved in this. We have legitimate interests in Central America. Many of us have supported increases, particularly in bilateral economic assistance.

I am not quarreling so much with that. I am simply indicating that, if we are comparing sub-Saharan Africa to Central America and if we look at what has happened since 1981, it is very clear that, relatively, speaking we have substantially increased our commitment to Central America in bilateral economic aid. In sub-Saharan Africa we have also increased our bilateral economic assistance but not to the same relative extent as in Central America.

You can argue about whether that is wise, but I think the record should be clear.

Let me comment for a moment on the budgetary problems since others have done so. As you know, by-and-large I support foreign assistance as an important tool of foreign policy. We have legitimate interests in the world, and foreign aid is one necessary tool in pursuing our legitimate interests. I have supported that over the years, by and large.

We may disagree on certain uses of aid; that is natural enough in our democracy. I have disagreements with the Administration, particularly in terms of the Nicaraguan policy. But I think it is important for us to have an effective foreign aid program.

At the same time, I have to agree with Mr. Obey this year. You understandably have a focus almost exclusively on foreign policy issues. We, in Congress, have to deal with the total budget.

I left a meeting this morning with local officials, Republicans and Democrats, and they were expressing very grave concern about the impact on their local communities of the termination of revenue sharing, the proposed termination of many economic development programs, as well as other cutbacks which would impact upon their communities and, in many cases, require them to increase their property taxes back home.

What I said to them personally was that if we are going to preserve these programs at some level and, at the same time, reduce our deficits, it is inevitable we have to raise some revenue to pay for them. The choice, if we are reducing our deficit significantly, is either to cut out these programs—as the President proposes in some instances—or to raise revenue to keep them going. We can't have it both ways.

I think it is important, as Mr. Obey said, to focus the same message here. If we are going to reduce the deficit, and particularly if we are going to cut back on programs at home, foreign assistance inevitably will take its cut. And while your responsibility is to explain to us the importance of these programs and why they should be funded at the levels requested, it is our responsibility, I think, in candor, to tell you, as Mr. Obey has, that these programs will take significant cuts unless we raise some revenue to help pay for them and, indeed, other programs which are considered essential.

My purpose in saying that is not to argue with you, because I know you are supportive of the President's budget priorities. That is understandable. But, honestly, as someone who has supported foreign assistance and believes it is important to our national interests, I have to say that there is no way in the world that this foreign assistance request can be funded to this extent. Unless we have the kind of budget compromise which helps to raise at least some revenue to sustain not only this program but some others that are important to those of us who serve in Congress—you need not comment further. I think you made your point earlier.

I do think it is important for you to understand that. You are a pragmatic person. I have a great deal of respect for you. We are going to have to come up with some pragmatic response to this budget problem, which will either be cuts in programs where they are less essential than in other programs, or some revenue to help pay for these requests. There is no other answer to the problem, as far as I can tell.

### SUPPLEMENTAL FOR PHILIPPINES

Let me ask you a number of questions. There has been reference to the Philippines. Like others, I believe the President and Congress played a constructive role in the Philippines. I think it is almost inevitable that, after the Administration has examined the situation further, and spoken with Mrs. Aquino and her ministers, there would be some requests for additional aid.

The economic problems in the Philippines, as you know, are quite severe. Do you anticipate we will be facing a supplemental request for the Philippines, either in terms of military or economic assistance?

Secretary SHULTZ. I would rather make my reply after we have the results of what Phil Habib's mission tells us, and until perhaps after Mr. McPherson has made his survey.

I have a sense, as you do, that there are great needs there. We will want to be helpful. We can be helpful. But rather than make a statement that is not well-based in exactly what kind of things will be most helpful to them, or in how what we do can be interrelated with what others do, I would rather just pass, but leave it in terms of—just as you did—a recognition that this is a situation that has been very thrilling to all of us in many ways, and we want to be part of the solution to help the democratic forces succeed.

So, we will want to look at propositions that come along. Just what they will be remains to be seen.

### GUATEMALA

Mr. McHUGH. That is fair enough. I understand.

Another country where it seems to me there is a critical moment facing us is Guatemala where, again, we have seen a democratic election. The Guatemalan people participated fully in that election, and the person elected is committed to trying to deal with the very difficult problems that Guatemala faces.

It is a country in which we have legitimate interests. Therefore, it seems to me that it would not be unlikely for the Administration at some point to propose some economic assistance to help Guatemala deal with its fundamental problems beyond what has been requested.

But I am not sure what the Administration is thinking along these lines.

I wonder, Mr. Secretary, if we can anticipate any supplemental requests for Guatemala?

Secretary SHULTZ. In the case of Guatemala, again, I agree exactly with your reasoning. The developments there have been very favorable. It has been a long, hard struggle. We want to support Guatemala. The 1987 numbers do that.

We have in development assistance, in the President's budget, $40 million; and in economic support funds, $70 million. And we have in Public Law 480, Title I, $19 million; Public Law 480, II, $4.7 million. We have $3.2 million for the Peace Corps. We have $10 million of MAP and $500,000 in IMET, making a total of $147 million. That is prospective, of course. That is all within the budget. It is within the framework of all the constraints.

In fiscal year 1986, we have very meager resources. That is because we had a cut of $300 million from the FY 1986 CR level. We wanted to reprogram it but we did not have anything to reprogram with—the cupboard was bare.

If we look to fiscal year 1987, we have a good, strong program; at least we think so.

Mr. McHUGH. Well, I would hope the Administration, if it sends us any supplementals, would recognize the need to propose revenues to pay for them in the context of what has been said here already.

Speaking for myself and recognizing that we do have critical interests in places like the Philippines and Guatemala, we should provide appropriate help. I couldn't support it unless we had revenue to pay for it, for all of the reasons which have been stated earlier.

I simply think it is important for you to understand that those of us who have been supportive of foreign assistance for years would not be able to support supplementals in the context of the budget problem we are discussing without increased revenues.

### PALESTINIAN INVOLVEMENT IN PEACE PROCESS

I would like, if I have another minute or two, to ask a question about the Middle East. We have seen what appears to be a breakdown, in King Hussein's efforts to promote the peace process, an initiative which the Administration has encouraged.

The King, as you know, has recently given a speech to his people indicating that his discussions with Arafat have broken down. There is hope in Israel, I am sure, that King Hussein will now negotiate directly with the Israelis, perhaps involving some Palestinians on the West Bank unaffiliated with the PLO.

What is your judgment about the prospects for any type of negotiations involving the key parties in that region, where we do have vital interests, again? Could you also address what concessions we were prepared to make by way of dealing with the Palestinians as part of the peace process?

I realize this second question may be somewhat sensitive and perhaps even academic at this point, but nonetheless King Hussein made express reference to it. I think we would like to know to what extent the United States would have been, and might again be, prepared to involve Palestinians in a peace process.

Secretary **Shultz**. We are always prepared to involve Palestinians in a peace process. In fact, I think it is essential because much of what you are talking about has to do with the conditions of life for Palestinians. So they have to be involved.

I do not think anyone questions it, not on the Israeli side, and certainly not on the Arab side.

The question, though, is what Palestinians? Naturally, the main thing we want in anyone who sits down at a peace table is that they are ready to make peace, and that, therefore, they renounce violence, and that, therefore, they accept the fact that Israel is there and is there to stay. It exists. It is going to continue to exist.

I almost hate to put it that way, because that is not a way of fully recognizing the vitality and democracy of Israel which ought to be present in these statements, and of course recognizing the validity of UN Resolutions 242 and 338 as a way to proceed.

Now, we have struggled with King Hussein and with the government of Israel. Everything we have done, we have worked together, very closely. We have struggled to find a Palestinian representation that would have the kind of legitimacy and support of the Palestinian community so they would be seen as real representatives, and the views of leaders of the PLO have relevance there.

We have, at the same time, fully recognized that those people have to be people that Israel will be ready to sit down with and talk with. So, the past activities and the terrorist activities of the PLO and of individuals in the PLO are quite relevant there.

So, there has been a struggle along that line. And then there has also been a struggle since—as you know—the Arab League declared the PLO to be the legitimate representative of the Palestinian people. So that gives King Hussein the need really to deal with the PLO; but a parallel need which he felt of having some sort of international conference or umbrella or auspices under which his efforts would go forward.

From our standpoint, our objective has always been very simple and clearcut. We wanted to see emerge from whatever process a direct negotiation between Israel and, in this case, Jordan, with legitimate and acceptable Palestinian representation. That has been the objective that has guided everything that we have done.

So, in one way or the other, as we have talked with King Hussein, we have talked about possible forums of an international conference, we have always had it tightly linked in our discussion with what the outcome would be. And we said at one point, because we felt it would be quite helpful to the King in dealing with the PLO—I want to phrase this carefully—that if there were an invitation to the PLO to a conference, we would not interpose an objection to that invitation.

Now, let me say that that explicitly describes what we were ready to do. But beyond that, it does not imply activities beyond the receipt by somebody of an invitation.

Now, I think the thing to notice here is, as you pointed out, that we have seen a long and arduous and creative effort by King Hussein to get the leaders of the PLO and Arafat, in particular, to accept 242 and 338, to accept Israel and be ready to negotiate with Israel, and to renounce violence, the armed struggle, as you go to the bargaining table.

There were times when the King was quite optimistic that that might be done, and a major effort was made to, in a sense, test the PLO. The British put forward a test. They said they would meet with representatives of the PLO if the PLO, before the meeting, would make those statements. It seemed that the meeting was going to take place. Then, at the last minute, they wouldn't do it.

The King has had the same experience. So I think what we see—I almost said "achieved"; I don't know if "achievement" is the right word—but we see that the leaders of the PLO were given every opportunity, and people bent over backwards to see how this process could be moved forward. And in the end, the PLO leadership would not move.

I think it is a great mistake and a tragedy on their part. It is true, as I think Defense Minister Rabin said at one time—he was asked about what his attitude would be if the PLO did all those things that I said. He said, well, it wouldn't be the PLO any more. It would be different.

That is true. That is what has to happen in some of these cases. People have to be different, in the sense of deciding that Israel is there, the armed struggle has gotten them nowhere, and they have to take a different course. If they will make that decision, then something fruitful might come forward. But the tragic fact is they haven't been willing to make it.

Furthermore, we see the great tragedy of the murder of Mr. Masri, the Mayor of Nablus, here a couple of days ago as a moderate Palestinian trying to play a constructive role. So, as always, we have the forces of peace and moderation, the constructive forces. There are always people ranged against them.

I believe that even though the difficulties are great and the probabilities are never in your favor, we should never stop trying to work for peace in the Middle East. It is of tremendous importance to us and to the region, and we just have to keep struggling and working at it, thinking of new ways to go about it.

Mr. McHugh. Thank you, Mr. Chairman.

Mr. Obey. Thank you, Mr. McHugh.

Mr. Edwards.

### PROMOTION OF DEMOCRACY

Mr. Edwards. Thank you, Mr. Chairman.

Mr. Secretary, I commented earlier about the request by the Administration to provide both economic and military assistance to the Contras in Nicaragua. I support your request, and I do that in the context of what you pointed out and what has been pointed out by other members here today about the move toward democracy in many parts of the world, particularly in Central America where Nicaragua stands out alone as a non-democratic force on the Central American mainland.

My friend, Mr. McHugh, referred to the progress that has been made in Guatemala. It would be a terrible tragedy if, after seeing El Salvador, Guatemala moves into the democratic camp with elected leaders who are popular in their country, and supported by people on both sides of the aisle in this country, we were to endanger those new democracies by failing to step in and take whatever actions we can reasonably take to prevent the export of revolution from a base in Nicaragua.

So, I think you are doing a good job there. I think that in terms of the growth of democracy, there are some lessons we can learn, not necessarily directly tied to foreign aid but for our foreign policy generally, with events in Guatemala, El Salvador, Haiti, the Philippines, and elsewhere.

There has been a common denominator. That common denominator is that viable democratic alternatives existed in those nations, and that the United States did whatever it could to foster and develop that democratic alternative, then drew a line and said there is a point beyond which we will not support dictatorships which are pro-Western, but which are really not in line with our way of thinking. And that was one reason for the success in the Philippines.

So, I would just encourage the Administration to continue to look for ways not to draw the line—I'm saying these are our guys and these are the other guys—but to look for ways to build the democratic alternatives in these various countries that are pro-Western, but that are repressive and are not democracies, so that we avoid any further Irans in the future and build on the great successes that your Administration has had.

I think it is ironic that some people in this country look at President Reagan and his Administration and see a hard line "Clint

Eastwood Administration," and that may be fine when he is reading one-liners from the cards, but that is not what we want.

What we are getting is a very reasonable and very successful foreign policy. I commend you again for that.

### CONSERVATION OF FUNDS

Let me ask you some specific questions, because I have a concern about the need to help in Nicaragua, help the Contras in Nicaragua, do other things that are on your priority list; and yet, as I mentioned earlier, I have great concerns about the money.

I don't think the Congress, people on either side of the aisle in Congress, are going to support a large increase in foreign aid. I am wondering if there are ways to find other revenue sources, short of the Chairman's recommendations which he alone is advocating for a tax increase.

For example, I don't know if my numbers are correct, but I understand that there is in the pipeline at the moment quite a large amount of money for a lot of countries. My numbers suggest that Egypt today has over $2 billion, $2.15 billion of U.S. aid in the pipeline. Pakistan has nearly half a billion. India has $382 million; Indonesia, $287 million; the Sudan, $280 million; the Philippines, $269 million. These are things that are already in the pipeline.

I am wondering what you have considered about ways to use that fund, that money that is already out there, to reduce the amount of new appropriation that is required? I don't know whether we are talking about less program funding for these countries that have a large pipeline buildup, or deobligating some of the programs that aren't moving along very rapidly so we can put more emphasis on higher priority ones.

Is there any way we can find some relief from this budgetary pressure by making better use of what is already out there?

Secretary SHULTZ. Basically, we have tried to skinny this down in every way that we can. As you know, commitments made with funds vary according to the speed with which they are spent. But a commitment is a commitment on a project of one kind or the other. We certainly have taken all of this into account.

I don't quite see where we would go. Since much of this pipeline is administered by Mr. McPherson, let me ask him to address himself to the question.

Mr. MCPHERSON. We have worked very hard on this exact question, and Congress has provided us with deobligation/reobligation authority which has given us some flexibility. That authority currently permits us to reobligate funds only within countries from which the funds were deobligated. Nevertheless, even if it were broader than that, our ability to use that pipeline would still be severely restricted because, for example, when we build a road we try to obligate the funds up front so that the project can proceed to full completion without interruption.

We have really struggled on this one. I feel very confident that pipeline funds are not the answer. Pipelines can be helpful at the margins, and you can be assured that practically daily I am struggling with those margins to figure out how to make your dollars stretch further.

Mr. **Edwards**. I would encourage you to—Peter, you might not want to pass the microphone back. I suspect the next question is also going to be directed to you.

You might want to look at that again, because the money that is in the pipeline tends to cause all of us to suggest that maybe if there are some of these countries—and I am not saying it applies to all the countries I mentioned—but if any of these countries do have available to them large amounts of U.S. capital for programs that haven't been completed yet or aren't well along, we ought to let them finish those before they take on something new.

Mr. **McPherson**. We would like to perhaps brief you or your staff, if you would like, on the problems and details.

The pipeline figures you have, I think, are snapshots of the last day of the fiscal year. That time of the year gives an extraordinary sum of undisbursed money. We would look forward to providing you with the problems of using pipeline funds in lieu of new budget authority.

[The information follows:]

### PIPELINE EXPLANATION

Pipelines result from conscious management decisions on the best way to achieve development objectives and are an inevitable part of project funded assistance programs. Much of the pipeline is in a few countries with large aid programs such as Egypt which accounts for roughly $2 billion of the total pipeline. Countries with large portfolios tend to have large pipelines because:

Such countries have larger than average projects which take longer to implement but require a high proportion of "up-front" obligations to ensure the project will be carried through to completion.

Full, or at least substantial, funding is required for large projects that are loan funded; when we ask a country to accept an obligation to repay us, we and they want to be sure the project is funded to completion.

Most large projects involve contributions from other donors such as the World Bank and the host country itself. Each of the several providers of funds, including A.I.D., must ensure that its full share of the overall project costs is covered.

Many technical assistance programs are implemented through multi-year commitments to contract teams from U.S. firms and universities. The advance funding represented by the pipeline assures the contractor that financial difficulties will not be encountered during implementation.

Finally, many of our programs include training of host country participants. When participants are brought to the United States for long-term study, A.I.D.'s policy is to fully fund the cost of this training at the outset to assure the participant and the host government that the training program can be completed.

Mr. **Edwards**. Peter, we have a considerable number of sales programs and grant programs. But more and more we have a lot of loan programs. We have been lending a lot of money to other countries.

I am not sure exactly where we stand in repayment. A lot of those loans are very concessional. They are the kinds of loans that you and I would like to be able to go down and get from our friendly banker—long repayment periods, very low interest rates, many of them in the form of projects. My figures are that as of September 30, 1985, we had provided $53.2 billion in concessional loans to developing countries. And I have no idea—I know you do—of how much of those loans have been repaid, how much interest we have collected, how much of it is past due, how much may be considered uncollectable, if you have any of those.

I wonder if you or the Secretary could address that, because that seems to be a continuing problem.

**Mr. McPherson.** I think we need to provide this data in detail to you directly or for the record, as you may wish.

First, I would make a couple of points, however. There is the Brooke-Alexander provision that requires that when a country does not keep reasonably current, as defined under the legislation, with its payments on these loans, then we are prohibited, with limited exceptions, from obligating any new funds for that country. That is true for economic assistance, as well as for military assistance.

There are a whole set of problems for the military sales monies, particularly that were loaned to countries during the late Seventies and early Eighties, that are now causing us big problems—Israel, Egypt, and some other countries. We have struggled with this and talked about this.

As for economic assistance, some of this aid is provided in the favor of loans, others as grants. We have the discretion to make the loan/grant split.

Generally, there is some value to having at least a small component, if not more, of a program be a loan, because loans usually have to be approved by the Finance Minister and then the country takes the assistance more seriously than it would a straight grant.

On the other hand, you don't want to load a country too heavily with debt. There are a variety of concerns and problems. Let us provide you with data.

[The information follows:]

### STATUS OF LOAN AGREEMENTS

[As of September 30, 1985]

The following information reflects cumulative loan activity for AID and predecessor Agency loans:

| | |
|---|---|
| Loans authorized | $33,236,077,066 |
| Loan amounts utilized | 31,363,273,861 |
| Loan principal repayment | 10,150,794,597 |
| Interest collections | 7,806,133,568 |
| Less interest capitalized for rescheduled loans | 560,383,920 |
| Net interest collections | 7,245,749,647 |

The information below reflects the condition of principal and interest past due at September 30, 1985:

| | Principal | Interest |
|---|---|---|
| Total due and unpaid | $153,912,980 | $116,090,033 |
| Due and unpaid over 90 days | 119,813,053 | 85,398,067 |
| Due and unpaid—considered uncollectible | 63,022,125 | 22,904,077 |

**Mr. Edwards.** Is it true that at the end of the last fiscal year, AID had about $19.3 billion in loans outstanding? That is my understanding.

**Mr. McPherson.** That sounds about right. We amortize our loans over long periods of time—20 to 40 years. So, of course, over a period of 25 years, the time we have been in business, we have a substantial outstanding amount.

Mr. Edwards. Are there any of those loans that you think may be moving the recipient countries into this category in which we have to consider cutting off continued assistance?

Mr. McPherson. Yes, there are several in which, periodically, it is clear they must either repay or no new obligations can be made.

Mr. Edwards. Can you give us that list?

Mr. McPherson. We would be happy to.

[The information follows:]

## Countries With Actual or Potential Loan Repayment Problems

[As of December 31, 1985]

### SECTION 620(Q)

Actual

Afghanistan
Argentina
Brazil
Costa Rica
Guyana
Iran
Laos
Liberia
Nicaragua
Peru
Syria
Tanzania
Vietnam
Zambia

Potential

Bolivia
Dominican Republic
Honduras
Ivory Coast
El Salvador
Chile

### BROOKE AMENDMENT

Actual

Ethiopia
Guyana
Iran
Laos
Nicaragua
Peru
Syria
Tanzania
Vietnam

Potential

Brazil
Costa Rica
Egypt
Ecuador
Liberia
Sudan
Zambia

Mr. Edwards. That is all, Mr. Chairman.

Secretary Shultz. I think Mr. Schneider would like to comment on your questions.

### DEBT SITUATION

Mr. Schneider. Mr. Edwards, just a brief comment related to the debt situation with respect to the FMS side. As you know, until recently we did not have legal authority to provide concessional loans. We could provide grant military assistance program funds which were a very small amount, as recently as 1980 only $100 million. We have won the support of the Congress for authority to provide a modest amount of concessional FMS assistance; that is, loans at about 50 percent of the cost of money to the Treasury.

The problem we faced, however, is the Congress has not supported our grant assistance request at anything like the level we have requested. We had more than a 25-percent cut last year from our request. This forces us into a position where we can only offer relatively expensive foreign military assistance credits to countries, many of whom should not really be using that kind of assistance because it is a drag on their economy.

### MAP REQUESTS

The 1986 figures in military assistance program funds were cut further from the amount provided in fiscal year 1985. So I hope we would get some greater support for our MAP requests this year so we can more effectively deal with this problem.

Mr. **Edwards**. I hope so, too.

### GRANT AND LOAN PROGRAMS

Mr. **Obey**. Mr. Schneider, in light of that last statement I want to read to you some numbers which belie what you just said, because the fact is that the MAP grant program in 1981—that is the giveaway stuff the Republicans used to squawk about when Democrats provided it—it was $110 million in 1981; it was $805 million in 1985. We cut it back slightly to $782 million in the 1986 budget. It is $996 million in the Administration's request this year, which is an 804-percent increase since this Administration came to power.

Now, I invite you to show me a single domestic program or a single international program that matches that kind of increase.

We were told when Jerry Ford was President that we were going to phase out grant MAP assistance. We were told then that we could not do it because the oil prices were increasing. So, we had to provide it. So, as a consequence, now we have gone from six countries who received MAP in 1981 to almost 40 who receive it today.

I ask you, since the oil prices are now going down, since the justification for increasing grant MAP assistance has been eliminated because the oil prices are now going down, why can't you reduce the number of countries that are receiving grant giveaway military assistance when you are asking us to cut the hell out of the domestic budget?

I don't mind you suggesting there is a direct relationship between credit programs and grant programs. That is obvious. But I do mind you leaving the impression that this committee gutted a program which has been increased by 800 percent since your boss became President.

Mr. **Schneider**. Mr. Chairman, I would suggest that when we are dealing with grant versus loan programs, they have the same budget effect. It is a question of the mix.

What the Administration has proposed is providing a change in the mix that would increase the grant and concessional components and reduce the relative weight of the cost of money loan program so as to reduce the debt burden on the recipient countries.

Mr. **Obey**. But under your program, you are increasing both. You are requesting in both this year.

I am sorry, but we simply can't afford it.

Mr. **Schneider**. The request is about the same level as we requested in 1986.

I appreciate the remarks you made earlier about the appropriation action last year. But we believe these levels are justified.

Mr. **Obey**. My kids ask for dessert every night, but they don't always get it.

Mr. Mrazek.

Mr. **Mrazek**. What a nasty father you are.

Mr. Secretary, I know what a pleasure it must be for you to come up here so regularly to be enlightened by us here on the Hill. I must confess that I am going to take an opportunity to deliver a brief statement, which is almost guaranteed to get your blood pressure up. I am going to ask you in advance not to respond to it. How is that?

Mr. **Lewis**. Wait a minute.

Mr. **Mrazek**. I simply want to get it on the record. Who knows? You might listen.

I guess one of the reasons I don't want to get your blood pressure up is that in another area—which I do consider to be far more important, which is the question of nuclear arms control—I have been going all over my congressional district telling everyone just how pragmatic you are and what concerns and objections you are facing within the Administration in trying to find a fair, verifiable arms agreement with the Soviet Union, and, if it would help you to get that agreement to repudiate what I just said, you are perfectly welcome to do so.

### NICARAGUA

Let me just say that, I think we all agree that in Central America, the goal is to produce stable democracies. You have suggested that the Sandinistas are the bad guys. Well, I don't know that there is necessarily a pristine symmetry in this world that means that just because there are bad guys, there are automatically good guys.

That is my concern about the Contras. I think if they were good guys, they would have far more indigenous support within Nicaragua than they have been able to demonstrate in recent years. If our key policy is to help build an established, stable democracy in that region, I would submit to you our policy at least in regard to support for the Contras is counterproductive in building a stable democracy within Nicaragua.

I think the Contras as a military force have demonstrated the same will and capacity to fight that our ARVN friends did back in South Vietnam. In those days, we were told by the President of the United States that we were assisting them to fight communist subversion and terrorism, and they were a fledgling little democracy. We invested 55,000 young Americans, 500,000 wounded.

I personally spent a few months in Newport Naval Hospital and was in a position to see the human costs of that war. We spent several hundred billion dollars, we sowed the country with Agent Orange, admitted to killing a few million Vietnamese, and when we pulled out that country collapsed like the rotten house of cards it always was.

Seventy percent of the Contras are sitting in their base camps complaining about their boots, apparently. I don't know if they feel they have to be accoutered by L.L. Bean in order to go and do what is necessary in Nicaragua, but the bottomline is I am concerned that this money is being utilized to support a gigantic and wasteful welfare program for the so-called Contra freedom fighters.

I fully support the position of those who say that the way to bring about the kind of democracy we are looking for in Nicaragua is to isolate the Sandinistas, if necessary. But this must be done with the support of our allies in the region. The only way we are going to get that support is, if in the face of a fair agreement, a regional peace approach, supported by the Contadora allies down there, that agreement is rejected by Nicaragua rather than supported. If a fair agreement is rejected, our allies will join us in a quarantine of that nation.

I would hope that the pursuit of colleagues like Dave McCurdy, who in the past have supported assistance for the Contras, at least so-called humanitarian assistance, was contingent upon some type of negotiated solution. It would appear that that is no longer something that this Administration wants to seriously pursue.

Now that I have gotten that out of my system, we can move on.

Secretary SHULTZ. I can't pass on such a load of misinformation.

Mr. MRAZEK. Oh, OK.

Secretary SHULTZ. In the first place, we are not going to improve the outlook for democracy in Nicaragua by allowing the Soviet-Cuban-Nicaraguan communist forces to consolidate a totalitarian regime there. That is the way in which you entrench that kind of a regime.

You are not going to give aid and comfort to the neighbors of Nicaragua by having them faced with an armed force in Nicaragua that is larger and much better equipped, has more modern armaments coming from the Soviet Union—half a billion dollars' worth in the last five years or so—looking down their throat. That is very intimidating, particularly when you combine it with the clear evidence of support for subversion in other countries, of support for terrorism aimed at other countries, financed in part by drug trafficking.

So, it is a cancer. It is a cancer.

As far as negotiations are concerned, we have worked to try to bring about a reasonable negotiated solution all along. We supported the Contadora process. We had very high-powered people spending all their time on it. We have supported—the President has supported—a peace proposal based on church-mediated efforts at internal reconciliation within Nicaragua. We are prepared to work for that today. So, there is no lack of willingness to try to negotiate it.

Furthermore, you are looking at somebody who made a trip to Managua at the urging of many of my friends in South America, particularly President De la Madrid, who urged the President and I that we should try to do that. I went. I might say, I didn't get universal applause from a lot of people for doing it.

We set up a negotiation. We had some nine rounds of talks designed to try to find reasonable solutions. What we found was the Nicaraguans using it in the end directly to undermine the Contadora process, which is what we undertook it to support.

Furthermore, as far as the support of the Nicaraguan people is concerned, the people that we are supporting in Nicaragua have gotten practically no support from us at all since the middle of 1984—zero. So, they are not living any country club life down there, certainly not at our expense. We have not supported them; and yet, they have continued to gain adherents.

Why? Because of what the Nicaraguan regime is doing. That is, turning off their population. That is why.

They also have developed a positive program of what they are for and published it and put it out in Caracas, Venezuela, where they had their meeting a couple of months ago on this.

So, I listened to you carefully. I was inclined not to take up time with commentary, but I feel that our differences are so great that I should comment. So now maybe we can go on from there.

Mr. **Mrazek**. Actually, I don't think they are so great in other areas.

I might point out that General Singlaub and my predecessor, Mr. Leboutellier, take some credit for sending in excess of $10 million in support to the Contras. So they apparently are receiving money from some quarters.

But the bottom line for me is I certainly agree with you that I don't want to see us supporting a nation that is exporting terrorism. But I assume that a half of such activities, if they are occurring, would obviously would be part of any agreement negotiated, and that we would be in a position to verify whether that was continuing, and then come on very strong if, in fact, it was violated.

### ECUADOR

I would like to move on to one of your success stories or one of the success stories you certainly played a role in. That is Ecuador. Mr. McPherson spoke about it briefly earlier.

President Febres-Cordero was elected on the free market program. His government has worked hard to eradicate drugs, stop terrorism, reduce subsidies, and open up foreign investment. The country has made great strides economically because they were willing to make a lot of politically difficult decisions. But now, based upon falling oil prices, it is my understanding that they are facing a $700 million shortfall in their budget this year. I know President Febres-Cordero wrote to President Reagan seeking additional assistance.

I wondered if you could comment on whether a response has been made to President Febres-Cordero on that additional request?

Secretary **Shultz**. We have been in very close consultation with the Government of Ecuador. I agree with you that they have been doing a very good job and we want to help them in every way we can to succeed.

Insofar as funds are concerned, I will ask Mr. McPherson to comment on that.

Mr. **McPherson**. Our FY 1987 program includes a $22 million DA, a $15 million ESF, and some Title II. We were able to free up a little additional Title I this year when the President was here visiting our country. We are struggling with this, frankly.

We realize that when oil dropped to below $20 a barrel, that there was going to be real trouble. We envisioned, frankly, having to continue to work with this. Part of the problem is that we just do not have any money in place. Every time we take from one trouble spot, to pay another, it is really robbing, to no real avail. But we are intensely aware of the situation in Ecuador.

Mr. MRAZEK. Are you acquainted with the most recent request that has been made by President Febres-Cordero?

Mr. McPHERSON. I personally am not. We have had constant conversations with him. Frankly, if he just made such a request, it is no doubt in the context of the dropping price in oil.

Mr. MRAZEK. Let me say my primary concern is that this is a genuine success story based upon a lot of the principles that I know you support. I would just hate to see the government take perhaps a different course, a different political direction as a direct result of something obviously totally beyond their control, when I think just a bridge may be needed until they get the kind of foreign investment they are looking for from the United States to bolster their economy a little more strongly.

Secretary SHULTZ. Thank you.

We see the situation exactly as you do. At the same time, we don't have $700 million.

Mr. MRAZEK. Is that what he asked for?

Secretary SHULTZ. That was the figure you used.

Mr. MRAZEK. Oh, no. I don't think he asked for that.

Secretary SHULTZ. What we do know is that he had worked out his plan, obviously initially based on a price of oil in the twenties somewhere. He had planned for how he would handle it as it went down to $20. He felt he would have a great deal of trouble if it went below that.

He is having his difficulties. He is a good manager. We are interacting with him. The Treasury has had extensive discussions with him.

I think it is well to recognize that this decline in the price of oil has a very good side to it. It is very tough on countries that export oil. But it is going to be a stimulant in the economy. It is going to help keep inflation under control. It is going to be associated, therefore, with perhaps some moderation in interest rates. And all of these things will have a plus side, perhaps not offsetting but at any rate give something to work with for a country like Ecuador.

I want to assure you we will be very attentive to their problems.

Mr. MRAZEK. For the record, a response—when a response is developed to Febres-Cordero, could it be presented to the subcommittee?

Do I have additional time, Mr. Chairman?

[CLERK'S NOTE.—A response was not provided by the State Department.]

Mr. OBEY. One short question?

Mr. MRAZEK. There are no short questions on this subcommittee. Are we going to be able to have a brief round of additional questions after the first set?

Mr. OBEY. I don't know how long the Secretary can stay.

Secretary SHULTZ. I am at your disposal, Mr. Chairman. I have been here since 9:30.

Mr. MRAZEK. One final question.

## PAKISTAN NUCLEAR PROGRAM

You made a point in your statement of expressing serious concern over the direction of the Pakistani nuclear program. Pakistan has denied that it is pursuing a program that would lead to a nuclear weapon.

But I am wondering, considering that the total funding that you have requested would go from $236 million to $975 million for Pakistan, and based upon our burgeoning positive relationship with India, I am simply wondering whether there is a way to certify or have President Zia or the Pakistani Government certify for the record to the Administration, prior to our making that kind of significant increase, that they are, in fact, not working on a nuclear weapon program.

Any comment?

Secretary **Shultz**. They have made such a statement.

Mr. **Mrazek**. Already?

Secretary **Shultz**. Yes, sir.

I don't think the numbers that you quoted are right. But, anyway, I will ask Mr. Schneider to come up with them.

Mr. **Mrazek**. It is an increase, I believe.

Mr. **Schneider**. There is nothing along the lines of what you described. The fiscal year 1986 levels were $625 million, total. The fiscal year 1987 request in total economic and military is $666 million. So, it is less than a $40 million change.

Mr. **Mrazek**. $666 million for a combined ESF and military.

Secretary **Shultz**. I would say, I think you are absolutely right in pointing out the development from India and its importance, and therefore the importance to them and to us of positive developments in the relationship between India and Pakistan.

I am glad to say there are some. I don't mean to say everything is going great, but there are positive developments. We regard that as a real plus.

Mr. **Mrazek**. It would be impossible to get any more secure kind of a commitment than we have already received, I guess you are saying, as far as their not pursuing a nuclear weapons program?

Secretary **Shultz**. We worked at this and worry about it a lot. I will just leave it at that.

Mr. **Obey**. Mr. Lewis.

## PAKISTAN

Mr. **Lewis**. Mr. Secretary, it does seem to me that it is obvious our friends are very capable of using us and validating their circumstances relative to our own very well. I would want us to look very closely at what Pakistan may be doing relative to our obvious interests in the flow of assistance where it is possible to Afghanistan. They play pretty good poker in Pakistan. Their interests are much broader than just Afghanistan.

If the price, by way of their requesting additional assistance, should become too high, maybe we have to reevaluate the way our assistance—whatever it—might be, might flow.

I am very concerned about capital flows to Pakistan for quasi-military needs that might be used in directions other than our interests in Afghanistan. The current improvement of relations between Pakistan and India are encouraging.

But the history between those two countries must have been constant concern. What I am really saying is that we should evaluate very carefully the pressures for their increased requests and evaluate also whether we don't have other avenues to accomplish what we want in Afghanistan.

Secretary **Shultz**. Well, I don't know of those other avenues.

Mr. **Lewis**. I don't, either.

Secretary **Shultz**. Pakistan is a front line state, in effect. It is right there next to Afghanistan, the Soviet Union having invaded their country. It has a $2½ to $3 million revenue squeeze within its own country. That is quite a burden.

It is handling it very well. I think their needs are there and we should support them. I feel very positive about developments there.

Mr. **Lewis**. Mr. Secretary, I have fundamentally agreed with that position and attitude, but in fiscal year 1987, the last year—that is the last year of the current $3.2 billion security assistance program with Pakistan. Recent reports indicate that the Pakistanis are seeking doubling of assistance in the follow-on period. I am concerned that we evaluate several sides of not only the way those monies will flow but what they may be used for. That is really the point to be made.

Secretary **Shultz**. We are in the midst of careful discussions with the Government of Pakistan about the follow-on program. We believe that there must be one. We believe that the idea of doubling the present levels is simply not compatible.

I gave the Chairman's lecture to them; that it was just not in the cards. I think we are in the process of trying to get everybody in a realistic frame of mind and support the President's budget. That is the reality.

Mr. **Lewis**. I was going to start our exchange by referring to the Chairman's lecture, as a matter of fact, before I got side-tracked by Pakistan.

I would like to compliment the Chairman for the way our hearings have proceeded up until now, this year. Frankly, those who suggest that our interests are best served when there is no politics when we leave our borders are correct, we have paid lip service to that in the past. Indeed, it is very helpful in this process.

You have been more than generous with your time extended to Members on both sides of the aisle. I think that is very helpful. I appreciate it.

One of the agencies in my district suggested we ought to be asking ourselves as we point with pride and maybe swallow—pound our chests about the Philippines—we ought to ask ourselves where have we been. Martial law has been there for a long time. The problems of a gap between the establishment of the Philippines and the working people is very, very real.

It seems to me it is clear that America's interest is best served when we are promoting, supporting, helping to expand freedom and democracy in the world. And in the case of the Philippines, you have indicated by your comment that it was the people of the Philippines who in the final analysis are reflecting their will in the course there. We are going to learn a lot from that experience, hopefully. We will apply it in other parts of the world.

You suggested that we ought to consider the importance of supporting freedom in Central America in terms of American interests, but in terms of peoples' interests as well. I wonder if there aren't some lessons that we ought to carefully evaluate that may come from these current pressure points?

### ACCOUNTABILITY OF FOREIGN AID

We are going to hear a lot about what President Marcos may or may not have done with AID and other kinds of assistance flows. I am sure the voices that presently are being moderate relative to Mr. Marcos' stay in this country are going to raise in terms of their intensity level. It seems to me that perhaps this is a pressure point where we can look at what is happening with dollars that flow to other countries in the world in our current programs.

Are the monies we are delivering to allies and friends throughout the world really getting to the people we purport to want to help in the first place? If, indeed, billions that will be set up and siphoned off by a few in the Philippines—is that happening somewhere else? If there is some evidence, what can we do about making sure the money gets where we want it to get in the first place?

It seems to me that we ought to be willing to be tough on our friends as we support freedom everywhere.

In our sessions recently, my colleagues wanted to put a fence around some money flowing to El Salvador to give us some assurance that democracy would continue to expand. Some of us suggested that as we put that fence around El Salvador funding, that maybe we should put a fence around Mozambique until an election was held there.

It seems to me as we promote democracy and freedom in the world, we ought to be willing to look at the potential value and impact of conditions upon our friends as well as upon other countries we hope to see change.

It occurred to me as Peter McPherson was commenting, or providing some assistance to us in responding to monies to Africa versus monies to Central America, that maybe we ought to more carefully evaluate how we measure trends or countries of need relative to the countries that may not be of need or may or may not be able to use those funds. We haven't given a lot of money to areas south of our border because of formulae for income.

I wonder if we should not reevaluate the threat to our interests of real poverty in Mexico and how do we impact that? The threat, indeed, of poverty in Brazil, and how do we impact that if we want to avoid revolution? Indeed, there are countries there that may be able to use properly directed assistance that aren't receiving assistance at all, while perhaps in some African countries the money can't be used effectively at all even though there is great need.

It is time, it seems to me, for us to really begin to measure how conditions can possibly help people as we in turn are attempting to improve and strengthen our own interests.

### NICARAGUA AND THE CONTRAS

Mr. Secretary, I would love to chat on and on from this side, but a lot has been said in the press recently about the Contras' base of support within their own region; that they are faltering, that Honduras is unwilling to really give the kind of support we would like, and neighboring countries are backing off.

Could you elaborate more on your view of the Contras, the present posture in the region, what opportunity they have for support from the outside, from outside their country as well as just the United States?

Secretary **Shultz**. I think the impression being created the last couple of days is entirely wrong. The fact of the matter is that Nicaragua is being seen more and more for exactly what it is: a very undesirable cancer in the region. The fact is, Nicaragua is becoming more and more isolated, not only in Central America and South America but in other areas of the world, as well as Europe. So, nobody has a good word to say for Nicaragua as the Chairman said in his opening remarks. So, there is no differences of opinion, really, about the nature of that regime and its undesirability.

Now, obviously, people watch what we do. This is our hemisphere, and they see the same as we see, a gigantic military buildup supported by the Soviet Union, with a lot of Cuban fighting people there. And they cannot help but say to themselves if the United States won't help people in that country who want to fight for their freedom or independence, where does that leave us?

So, they are worried. It is not only the people fighting for freedom in Nicaragua that are worried; the people all around there are worried. So I think it is essential myself that we do support those who are fighting for freedom in Nicaragua.

Mr. **Lewis**. David, I was going to try to get very specific.

Reports are indicating that individual countries like Honduras are not—are backing off of their willingness to give support for—allow their territory to be a part of an exchange that takes place in the region.

Is there support that is overt on the part of those surrounding countries? Is there a backing off on their part?

Secretary **Shultz**. I think if Congress votes for this program, we will not have any problems in administering it. We have problems administering anything; I don't mean that. We will be able to handle it well.

Mr. **Obey**. Mr. Lehman.

Mr. **Lehman**. Thank you, Mr. Chairman.

I will yield the first minute of my time to Mr. McHugh.

### DEMOCRATIC PROGRESS

Mr. **McHugh**. I thank my friend for yielding.

Mr. Secretary, I have one additional point I would like to make on Central America so that my earlier comments are in perspective. I think it is important that we have seen the emergence of at least the beginnings of democracy in Central America. I specifically refer to Guatemala and the election of Mr. Cerezo. On that basis, I have indicated that I would certainly be supportive of additional economic assistance, assuming we can afford it in the context of our budget.

I think it is also important for me to say in fairness to my own views that there is more to democracy than simply the election of a president, as important as that is. Democracy also means that the military is responsive to the elected leader; that there is a judicial process which works in a way which is consistent with democracy; and other obvious elements.

I recognize in a place like Guatemala, and even in El Salvador, it takes time for a committed leader like Mr. Duarte or Mr. Cerezo to make progress in these areas. We should not expect immediate solutions to these problems.

On the other hand, the support I and others would offer for these governments is dependent upon that continuing commitment and indeed upon real progress being made in these areas so that real democracy evolves—not just the election of a leader, as important as that is, but also progress in these other areas.

I wanted to make that point since I did indicate my support for some help at a critical moment, which I think is important to our interests, but in the context of these other issues, democracy as well.

Secretary SHULTZ. I agree with your comments wholeheartedly, absolutely. There are all kinds of ways in which we have been trying to support them.

There is an interesting program, for example, on judicial reform that we could describe or you probably are familiar with. At any rate, there are lots of ways in which we are trying to follow through. When something happens like the victory of a new leader in Guatemala or the Philippines or something, a lot of people take a deep breath and say, well, that is behind us and they shouldn't.

We should say now the problems begin because we have to do everything we can to help make that process succeed. It is hard work, as you know.

### TERRORISM

Mr. LEHMAN. Thank you, Mr. Chairman.

I am sorry for being late, Mr. Secretary. I had to chair my own Subcommittee on Transportation.

I have met with the Federal Aviation Administration to look at some of the airport security in Europe. I know anti-terrorism has been one of your top priorities. We will also have a member of your department with us when we take a look at these situations.

In that light, Mr. Secretary, can you characterize our success or lack of success with urging our allies and others to cooperate with us on anti-terrorism? Which countries have been most helpful so far, and which ones have not, especially with regard to airport security?

Secretary SHULTZ. I think in general we have seen a very good response from our friends around the world to working on the problem of terrorism; some more than others, some more effective than others. But, in general, people are more and more seeing the importance and the international dimensions of this problem.

Insofar as airport security is concerned, I don't consider myself an expert to give you expert testimony on it, but I think the general alertness to the problem has risen greatly. Unfortunately, the need for it has gotten a lot of publicity by these terrible acts that have taken place, such as in Rome and Vienna. We have had the experience in the Athens airport of a long period of pointing out to the Government of Greece that we did not think the airport was operating adequately, and then that turned out to be so.

We issued a travel advisory. It did seem to have some effect. They have since moved on it. So, in one way or the other, we are working at this problem and we will welcome an opportunity to take part in working at it with your subcommittee.

Mr. **Lehman**. Have any of our allies or other countries been less than forthcoming with regard to this anti-terrorism priority that so concerns you as well as the rest of our country?

Secretary **Shultz**. Well, when you say less than forthcoming, it isn't like there is a switch and you are either here or there. It is all through in-between. For example, on our efforts to isolate Libya, which we feel is undoubtedly a supporter, a center of terrorism, we have had some success; but we still see that Libya's oil is bought by Europeans on a great scale, and we wish that it weren't.

So, we succeeded to some extent in our efforts. But there is a lot more to be done.

I would point out to you that Prime Minister Craxi of Italy made some very strong and good statements on this. Italy is the country that probably has had the closest and longest link with Libya. So that is a measure of progress.

Nevertheless, there are still plenty of problems.

Mr. **Lehman**. Thank you very much, Mr. Secretary. I will be working with your staff in regard to this. I know how important it is to both of us.

I yield back the balance of my time, Mr. Chairman.

Mr. **Obey**. Thank you.

Mr. Porter.

Mr. **Porter**. Thank you, Mr. Chairman.

Mr. Secretary, you will be happy to know that Bill Frenzel, Hank Brown and I presented a budget today that only cuts $1 billion out of the foreign assistance account. So, maybe we will be better off that way.

### METHODS OF ACHIEVING DEMOCRACY

I have an academic question for you that I am interested in your comments on. When previously the United States helped in various ways to topple the regimes of the Shah in Iran and Samoza in Nicaragua, there was great criticism that there followed even more repressive governments than the ones that were already there.

Now we have helped topple regimes in the Philippines and Haiti. You can distinguish those situations on the basis of results, obviously, at least as we can see results at this point in time.

But what differences were there in approaching the Filipine and Haitian regimes and the situation in those countries that led us to believe that we were going to have a better result there than we ultimately had in Iran and Nicaragua?

Secretary **Shultz**. First of all, we don't have results yet.

Mr. **Porter**. That is right; you don't.

Secretary **Shultz**. Something has happened, and the future lies ahead of us.

Haiti and the Philippines are totally different. They shouldn't be—I know, because the time is close, they tend to be said in the same breath, but they are just totally different situations.

In the Philippines, what you had was a contested election that with all of the criticisms that people make, it was still a contested, two-party election, with freedom of assembly, campaigning, and so on. And I think the evidence is very clear that there was an outcome, and the outcome was a victory for Mrs. Aquino. And when it seemed that it was going to be declared otherwise, or was declared otherwise, there was sort of an instinctive reaction to that.

So, in a broad sense, you can say that we had an election and now we have an outcome from that election. And we—and a government is forming itself. I think there is every reason to be optimistic that it will be a sensible government. We want to help along those lines.

In the case of Haiti, there was no election. There was an objection—rising objection and a kind of outpouring which in the end led the dictator to decide that he was unable to govern. So, we agreed with that. So, we helped to provide a place for him to go and we put him on an airplane and took him there.

Now, the problems of Haiti in the future are great problems. Their resources are minimal. It is very difficult, and we are again—Mr. McPherson and company are working at it. I hope we can get a good result.

I would like to interject a note here, though, something that does not get said. Everybody has on their mind Cuba, Nicaragua, and Iran, cases where you had overthrows, and the result from the standpoint of the United States is bad. However, we look at history of the last three decades. What we see is a strong flow of success, of movements toward democracy: Costa Rica in the late 1940s; Venezuela some years later; just a complete sweep in Central and South America recently.

We have talked about Guatemala, but it isn't as though Guatemala stands by itself. Somebody talked about Brazil, Argentina, and so on.

Or, if you look at Europe, we see what has happened in Greece, in Turkey. We see in the Iberian Peninsula a very exciting move to democracy; Portugal, Spain. So, the bulk of experience is that freedom has been able to win out, and I think the reason is clear: People like it. It just thrills them.

One of the most striking experiences I have had since being Secretary of State was when I happened to be visiting Portugal and the Prime Minister, then Mr. Soares, who has just been elected their President—but he was Prime Minister at that time—just came back from the inauguration of President Alfonsin in Argentina, to Lisbon. He had arrived literally hours before I did. So we met, and that experience was very much on his mind. He could hardly talk about anything else, because the whole idea of freedom gripped him so.

And, of course, I kept saying to myself I have never lived under any other conditions. So, I know it is important. But this man has lived under very different conditions and he sees how vital it is, how much a part of humanity it is. That is the reason why it has persevered in most cases. I think that is what we have going for us.

Mr. PORTER. I was beyond that. I was attempting to see what our policy is. What you seem to say is that everything is generated by events, and we are simply responding to events that occur.

I guess what I am asking, Mr. Secretary, is what is our policy toward regimes that are friendly but who do not share our values of human rights and democracy, and are we simply looking for openings where events can lead us toward greater democracy? Or are we trying to make those openings? What is our policy rather than how do we respond to events?

Secretary SHULTZ. Each country in its way is unique, and so I think the application of formulas is probably not a good idea. The power of the idea of freedom and democracy is such that even those who perhaps don't fully believe in it espouse it, and feel that they need to work toward it. So on a rhetorical level, by and large, we find ourselves in agreement; but we have to cut and fit and work with situations.

But the general line of our values and policies is quite clear, and I think that people fully recognize that. But we are not in the regime-toppling business. We don't go to countries with the idea of toppling people. We are there working with people who are there, and our values are clear to them.

### HUMAN RIGHTS

Mr. PORTER. Recently, you met with Mr. Ceausescu in Romania. I understand part of that discussion included questions of human rights in that country, particularly as they obtained the freedom of religion and some of the actions they have taken against religious minorities there.

Can you tell the subcommittee what kind of assurances on that subject, if any, Mr. Ceausescu offered, and whether you think given the human rights situation in Romania it might be wise policy to withdraw the most-favored nation status for them for a short period of time to send them a message?

Secretary SHULTZ. Well, they have the message. It has been delivered by a lot of people. And the response in the meetings is pretty cold.

Now, if you take the human rights scale as such, the scripted picture is a mixed one. Certainly, there is a kind of ultimate human right if you are allowed to emigrate and find yourself another place; and on that dimension, the Romanian performance has been pretty good.

One of the arguments I had, on the other hand, with President Ceausescu had to do with the availability of Bibles. I advocated allowing Bibles to be shipped in. He said, well, we have a church here that the state supports, and it prints all the Bibles that anybody wants. So people can use that Bible, the one that we have approved of.

So we argued about that point. We didn't come to any agreement. So you can take issues here. And I think it is something to be worked along at quite carefully, and I would not jump to any conclusion.

I have asked one of your former colleagues that you all know very well, Ed Derwinski, to be especially informed and knowledgeable about this issue. He will be around and working quietly with you and members of the Senate to let you see what our views are. But in the end, it is going to be a question of judgment, and there will be a lot of things about Romania nobody likes. There will be things we do like. You will have to decide what you are going to do with this mixed kind of situation.

### TAIWAN

Mr. PORTER. Mr. Secretary, the Administration is proposing selling a package of avionics and software upgrades to the Chinese Communist Government to bring their F-8 fighter planes into a new generation. At the same time, our friends and allies on Taiwan see this as a great worry to them in terms of defending themselves against any possible aggression from Mainland China.

How are we working out this policy and protecting those who do share our values as opposed to those who don't seem to, and protect Taiwan in terms of their defense needs?

Secretary SHULTZ. Well, I think our views about Taiwan have been made clear. It is a very, very sensitive subject with the People's Republic of China. But we have made our views clear.

At the same time, we have seen our relationship with the People's Republic of China expand and diversify and begin to take some shape on a military level. We believe that the needs of the PRC for modernization, given the threat they face on their border with the Soviet Union, given the fact that they see the Soviet Union in Afghanistan in another dimension, that they see the Soviet Union in Vietnam, are all very real observations. And their defensive capabilities, enhancing them somewhat, is in our interests.

Mr. PORTER. Thank you very much, Mr. Secretary.

Mr. Chairman, I have other questions to submit for the record, if I may.

Mr. OBEY. Sure.

[The questions follow:]

## Questions From Congressman Porter

*Question.* Why haven't representatives from the Nicaraguan Humanitarian Assistance Office been allowed to participate in the overseeing of the distribution of funds and equipment?

Answer. The political sensitivities in the region have precluded NHAO from establishing a physical presence there and overseeing the distribution of supplies in the field. However, NHAO is able to tightly control the expenditure of funds and thereby the kinds of supplies being made available for distribution. In this connection, NHAO maintains rigorous procedures to prevent the diversion of funds to unauthorized purchases.

*Question.* In the declaration of Shanghai, we committed the United States to a policy of not upgrading our arms exports to Taiwan. Meanwhile, we have just signed a deal with the PRC to upgrade their F-8 fighter with sophisticated avionics and software. While I realize the limited nature of the F-8 deal, have we now agreed to the principal of upgrading our exports to the PRC, while holding back on Taiwan?

Answer. This Administration is committed to full implementation of the Taiwan Relations Act which stipulates that the United States will provide to Taiwan arms necessary to maintain a sufficient self defense capability. In accordance with this legislation, Taiwan's defense needs are under continuous review.

U.S. willingness to release specific defensive weapons or technologies to the PRC is based on a thorough analysis of an item's utility for enhancing Chinese defensive capabilities, taking into full consideration the political-military environment and the interests and concerns of our allies and friends in the region. The proposed F-8 upgrade program does not include the provision of an offensive capability that could be threatening to Taiwan or other friends and allies in Asia.

*Question.* (Mozambique): Zimbabwe's involvement in this struggle has grown over the last year. By one estimate, they have 6,000 troops in Mozambique costing $1 million a day. I have heard recent reports that they have pulled back from their active role fighting Renamo. Is this true and did we have anything to do with this?

Answer. Zimbabwe's involvement in Mozambique is based in large part on self-interest; several of its essential transport links with the outside world run through that country. Zimbabwe's military has been protecting the vital road, rail and petroleum pipeline corridor from Mutare, Zimbabwe to the port of Beira as well as patrolling the route through Mozambique linking Zimbabwe with Malawi. Last winter the Zimbabwe Army undertook some joint offensive operations with the Mozambicans against Renamo, but we understand that the Zimbabwe forces are again limiting their activities to more classic corridor defense operations. Zimbabwe's involvement in Mozambique is a bilateral matter between these two countries. The U.S. Government has not been involved.

## CHILE

*Question.* In your budget submission for FY 87, I found that we had proposed initiating a military training program with Chile. Given the human rights record and recent "state of siege" in that country, why have you chosen now to propose this program?

Answer. Provision of IMET training to Chile is, of course, dependent upon presidential certification under section 726 of the International Security and Development Cooperation Act of 1981, which addresses the human rights situation among other factors. We do not believe conditions in Chile permit certification at this time. Serious human rights violations persist, as indicated by our 1985 human rights report and by our resolution on Chile approved in the recent session of United Nations Human Rights Commission.

For FY 1987, however, we do not want to rule out the possibility that conditions in Chile might change so that the certification under section 726 could be considered, in close consultation with Congress. If implemented, an IMET program would be consistent with our policy of encouraging a dialogue within Chile on transition to democracy and improved human rights practices. Resuming limited military training would enable us to expand our contacts with the Chilean military, which would over time serve not only our security objectives, but also our interests in democracy and human rights.

*Question.* A recent article in the Johannesburg *Star*, reported that 6,000 bags of soya-milk powder clearly marked with the statement "given by the people of the United States—not for sale" were being sold in South Africa. I was not aware that we had a P.L. 480 program in South Africa or that this food was allowed to be sold. Have you seen these reports? Don't they indicate that someone in Southern Africa is selling large amounts of our relief aid?"

Answer. Investigation of the South African newspaper story indicated that the contract numbers on the bags seen by the newspapermen corresponded to a shipment consigned to the World Food Program for use in Botswana. Although the food belongs to the WFP, we maintain an active interest in its disposition. Thus we requested South African authorities and the WFP to investigate the provenance of this food.

Preliminary results of that investigation reveal a maximum of 123 tons of food intended for transshipment through South Africa for Botswana that is not yet accounted for. It now appears that this food or a portion of it was auctioned off by the South African Railway as distressed cargo-goods which somehow went astray in the system and were sold to recover transport and storage costs. In other words, this seems to be a lapse of judgment rather than fraud. Agreement has been reached between WFP and the South African Railway that any future distressed cargo belonging to WFP will be sent to the WFP offices in Lesotho rather then auctioned.

### IRELAND AND CYPRUS

*Question.* It is my understanding that the U.S. has two outstanding commitments totailling half a billion in aid. These are commitments to provide $250 million in aid to back the Irish settlement and another $250 million to back a Cyprus settlement. Can you bring me up to date on the status of these two commitments?

Answer. There has never been a specific government-to-government commitment for an assistance program in dollar terms for Ireland. The Administration has consistently maintained, however, that if agreement could be reached between the people directly concerned about Northern Ireland, the United States would be prepared to look for tangible ways to assist in the Northern Ireland reconciliation process.

Following the signing of the British and Irish Governments' Agreement of November 15, 1985, the Administration therefore proposed a mixed program to stimulate long-term economic revitalization of Northern Ireland and areas of the Republic of Ireland most affected by the troubles of recent years.

The Administration's proposal, submitted to the Congress on March 4, calls for assistance by the United States of $250 million over five years. Our proposal consists of up to $100 million in seed money to help launch an international reconstruction fund which will be established pursuant to the November 15 Agreement, and of up to $150 million in various investment and trade incentives to stimulate private sector participation in the area's development. This proposal to support the Anglo-Irish Agreement is pending in the Congress.

Regarding Cyprus the President announced on May 8, 1984 that he is prepared to work with the Congress in committing up to $250 million for a special Cyprus Peace and Reconstruction Fund. We informed the interested parties of the President's proposal. However, we have never made any specific commitments. At such time as a fair and equitable solution acceptable to both parties on Cyprus is reached, or substantial progress is made toward that end, the Administration would consider making an appropriate pledge, subject to the necessary authorization and appropriation by the Congress.

### CONTRAS

Mr. OBEY. Mr. Secretary, I know we have kept you a long time. I have a series of seven or eight questions on the Nicaraguan situation to which I would appreciate having a response in the record this week, if possible.

[The questions follow:]

## Questions From Congressman Obey

*Question.* How does the Administration's plan to provide $100 million in military and humanitarian support to the rebels respond to the position of the Contadora countries?

Answer. The Contadora countries have promoted the negotiation of a comprehensive and verifiable settlement that would include a prohibition on external support to guerrilla forces. We support such an approach.

More recently, the Contadora countries have called for a cessation of such support in advance of agreement. There would be no verification that such actions were actually being taken. We believe that the first approach is the sounder of the two.

*Question.* The February 10th communique indicates that Central America countries endorsed this concept on January 14th in Guatemala. Do we in fact have any support in Central or Latin America for military or humanitarian support for the Contras?

Answer. In the countries closest to the problem—El Salvador, Honduras, and Costa Rica—there is strong public and clear, if indirect, official support for putting pressure on the Sandinistas, including military assistance to the Nicaraguan resistance. A poll conducted by a Costa Rican affiliate of Gallup shows strong majorities favoring military aid to the Nicaraguan resistance. President Duarte has publicly stated that the Nicaraguan resistance constitutes a "barrier" against Sandinista support for the Salvadoran guerrillas. President Monge has concluded from efforts to negotiate a border agreement with the Nicaraguans that (international) "pressures are necessary." President Azcona stated in a press conference in Washington last December that pressure on the Sandinistas is necessary. President Febres-Cordero of Ecuador has publicly supported the President's aid request.

The surprising thing is not that so few have spoken up but that—in view of the history of Latin resentment of US power and Sandinista intimidation through the largest military establishment in the history of Central America—that so many have made their position known.

*Question*. Have you talked to President Arias Sanchez and other Central America leaders on their position on Contra assistance?

Answer. I have met with Central American leaders on several occasions to discuss this and related issues. The President's Special Envoy, Ambassador Philip Habib, met with them as recently as last week. Although he does not favor military aid to the Contras, President-elect Arias Sanchez has spoken of Nicaragua as a "Cuba in Central America" and favors strong political pressure on the Sandinistas to democratize.

The attitudes of other Central American leaders are addressed in other answers.

*Question*. Shouldn't the United States be proceeding with an approach that can be agreed to by countries in the region that are most affected by the Government in Nicaragua?

Answer. Our policies and those of the Central American democracies are in accord. The President of Costa Rica, Luis Alberto Monge, stated the following publicly on March 17:

". . . we recognize with regret that three years have elapsed without any positive steps in Nicaragua toward the necessary conditions for reaching peace and democracy in all of Central America. In the meantime, in El Salvador, Guatemala, and Honduras there has been definitive progress on the path of democracy. Democracy is the indispensible prerequisite for the establishment of peace. This is the first time in the history of Central America that, together with the century-old democracy in Costa Rica, there have emerged at the same time civilian governments elected by their people in Guatemala, El Salvador, and Honduras. I have discussed with the President-Elect, Dr. Oscar Arias Sanchez, the results of his visit to the presidents of those three countries and we agree completely in the support for the initiative of President Napoleon Duarte in the sense of 'inducing the leaders of Nicaragua to recognize the urgency of opening a dialogue with their opponents and creating the conditons necessary for reaching peace in the Isthmus and consolidating democracy'."

These are the views of the United State Government as well: we support democracy and believe it to be indispensable for peace, and we support the call for a dialogue with the opposition initiated by El Salvador's President Duarte. Aid to the Nicaraguan resistance will, we believe, be one of the factors (the others being diplomatic and economic pressure) "inducing the leaders of Nicaragua to recognize the urgency of opening a dialogue with their opponents. . . ."

Remember, it was Nicaraguan President Daniel Ortega who wrote to the OAS on December 2, 1985, requesting a postponement in Contadora talks until May 1986. The OAS subsequently rejected that proposal by a vote of 24 to 1.

*Question*. Administration estimates of Contras to receive assistance range from 17 to 20 thousand. Your new proposed $30 million package would therefore work out to between $1,500 to $1,700 per Contra. The full $100 million package works out to between $5,800 and $6,600 per Contra.

How do you think this Contra aid is going to go over in Honduras, where the per capita income is estimated to be $670 or in Costa Rica where the per capita income is estimated to be $1,020?

Answer. There is really no basis for comparison. The Nicaraguan democratic resistance is involved in a struggle for the freedom of an entire nation, a nation of three million people. This aid package will help bring the original goals of the revolution to all Nicaraguans. That works out to $33.33 apiece, a small piece to assist the development of democracy in Nicaragua, a development which will benefit Honduras and Costa Rica as well as the other nations of the region.

*Question*. Are there any other aid programs that you know of where we are spending from $1,500 to $6,600 per person?

Answer. We know of no such aid programs, but as noted in the previous response the population base for such an analogy should include the entire country not just those who have taken up arms to secure the freedom of all their countrymen.

Using this mathematics, calculating Soviet/Cuba assistance to the Sandinista military machine—they have spent $4,166 per Sandinista soldier over the past 5 years. And Nicaragua is a country where the per capita income is $1,000, and falling.

*Question.* Does the Nicaraguan Humanitarian Assistance Office actually distribute and account for the humanitarian assistance funds in the area of concern? In other words, are they present when the assistance is distributed to the Contras?

Answer. For the reasons given to a subsequent question below, NHAO cannot maintain a presence in the area of concern, and NHAO personnel, therefore, are not present when the assistance is finally distributed to the resistance forces.

However, NHAO can and does account for the assistance funds, through detailed records and receipts for every transaction. These include invoices for purchases of goods and services (both in the U.S. and in the area of concern), shipping manifests, delivery receipts, records of payment, etc.

*Question.* If not, who is taking care of this distribution?

Answer. The constituent organizations of UNO, namely, the FDN, the FARN, and KISAN, are principally responsible for the distribution of aid to the combatants. To monitor the distribution process, NHAO has had to rely on the information-gathering agencies of the USG. Recently, however, NHAO was able to send a staff member to the region for two weeks to discuss supply procedures with the resistance and its regional suppliers. He also was able to confirm the delivery of various NHAO-purchased supplies to the democratic resistance.

*Question.* The FY-85 Supplemental Conference report states that the funds for the Nicaraguan democratic resistance "are to be provided by such department or agency of the United States as the President shall designate, except for the Central Intelligence Agency."

Is the CIA involved in providing funds or goods to the Contras?

Answer. The CIA is involved in providing funds or goods authorized by the Congress for the Nicaraguan democratic resistance and administered by NHAO. The CIA has been authorized by Congress to secure communications equipment and training for the equipment. This involvement of the CIA was approved by the Intelligence Committees in the Intelligence Authorization Act for 1986.

Mr. OBEY. I would like to ask you three right here.

### COMMITMENT OF CONTRA FUNDS

First of all, following up on Mr. Lewis' questions, the thrust of his question indicated the concerns that some of us have that money which we are presently appropriating to the Contras has had difficulty getting through.

Of the $27 million appropriated for humanitarian assistance, how much to date has actually been delivered to the Contras in the region?

Secretary SHULTZ. Our ability to commit funds has been based according to a schedule, and up until very recently we have been able to commit $18 million of the $27 million.

Now, with the most recent report to the Congress, we can commit the balance. So at least as of the moment what we are talking about is the $18 million.

Mr. OBEY. Excuse me.

When you say 18, are you including money that has been delivered to the Contras within the continental United States, or are you talking about money that has actually been delivered on the ground in the region within Central America?

Secretary SHULTZ. I haven't commented on that yet. I am first trying to make clear that when you make a comparison of how much has been delivered with something as of right now, the something is probably 18 rather than 27 because the money is not commitable, wasn't all commitable right at once. I went through a series.

As of now—the last balance we can make a commitment. Now, of the 18 that we have been able to commit, I think basically all of it is committed, and I may not be totally up to date but I think something on the order of $10 million has actually been delivered. There are difficulties——

Mr. Obey. So, it is 10 of the 27 that has been actually delivered to date?

Secretary Shultz. We haven't been able to make a commitment on $9 million.

Mr. Obey. I understand. I am just trying to find out exactly what the numbers are; and the numbers so far have been $10 million.

Secretary Shultz. Don't hold me to that. This program is being administered with very careful accounting to be able to trace it on through with great care.

Programs of overt assistance to people in a country fighting against the government of that country are extremely difficult for their neighbors to handle. That is a reason why the Administration has argued as a generality that if we are going to be willing to support people fighting for freedom in a country, we should have the ability to use covert assistance. So, when you do it overtly, you have difficulties.

But gradually those difficulties have been resolved, and I think as of now our, so to speak, delivery problem is able to go forward all right.

Mr. Obey. So you are saying that because the assertion has been made by a number of people that the reason that number is so low, the reason we are talking about 9 instead of 18 or more, is because of the difficulty we have had getting it through places like Honduras and Costa Rica? Are you saying that is not correct?

Secretary Shultz. I said that is correct.

Mr. Obey. Okay.

If that is the case, then let me ask you if we have had difficulty delivering an amount that small, if you are talking about providing the total package of $100 million, you are talking about providing about $6,000 per Contra, why should we believe that that assistance can be provided to any greater—or with any greater degree of speed than the original assistance was?

Secretary Shultz. Because we have learned as we have gone, and I think that we have our problems basically straightened out, and the full sum is divided into different manners of administration.

### NICARAGUAN HUMANITARIAN ASSISTANCE OFFICE

Mr. Obey. The Administration has established the Nicaraguan Humanitarian Assistance Office to administer that $27 million?

Secretary Shultz. That is correct.

Mr. Obey. That office, does that work out—only out of Washington?

Secretary Shultz. It is a Washington office, and you better put some questions in the record and let me do it. I want to be very careful since this is something that I administer. I don't have the information right on top of my head here.

Mr. Obey. There is one other question I did want to ask in that regard. If you can answer it, fine.

Secretary Shultz. I might say, Mr. Chairman, there has been periodically full testimony by the people administering the office to the various committees. So there has been a total availability of information to the Congress.

Mr. **Obey**. The only question that I have in this regard is, since it is my understanding that that is only a Washington office, my question is, do you have personnel from that office present when the assistance is distributed? And, if not, who actually takes care of the distribution?

Secretary **Shultz**. We don't have anybody in Nicaragua, zero.

Mr. **Obey**. But who takes care of the distribution in other countries besides Nicaragua? In Honduras, for instance?

Secretary **Shultz**. I would like to answer that question for the record as to precisely how this is done, and to some extent it is not desirable for us to publicize this.

[The information follows:]

Supplies procured in the United States are collected by UNO at its warehouse in the United States. They then arrange for transport to the region. Procurement of supplies within the region is done directly by UNO. When NHAO is satisfied that these purchases are within legislative guidelines, competitively priced, and delivery to the resistance forces has been made, NHAO reimburses the suppliers. While NHAO is precluded from having its own representatives in the region due to diplomatic sensitivities, NHAO is able to monitor and verify receipt of NHAO-purchased goods through existing U.S. information and intelligence gathering organizations.

Mr. **Obey**. OK. I will buy that, Mr. Secretary.

### CONCERN ABOUT NICARAGUA

I know you have been here a long time. Let me just sum up with my concern about Nicaragua.

You indicated earlier that you were happy I said the Contras were the good guys. I said I didn't want to be described as saying that. I regard certain people in the leadership levels as being decent human beings.

When I say Edgar Chimora, who was a former highly placed individual within the FEN—when I see him describing his experience as a director of the Contras, and when he says during his four years as a Contra director:

> It was premeditated policy to terrorize noncombatants to prevent them from cooperating with the government. Hundreds of civilian murders, mutilations, tortures and rapes were committed in pursuit of this policy, of which the Contra leaders and their CIA superiors were well aware.
>
> Only when these practices were revealed in the U.S. press and by human rights groups did the Contra leaders feel compelled to give lip service to ending them. But no serious effort to stop them is being made because terror is the most effective weapon of the Contras.
>
> In August 1985, Mr. Chimora states—I don't assert the accuracy of this, but this is his letter in the New York Times—"In August of 1985, in a typical case, the Contras briefly occupied the town of Coapa, gathered the residents in the town square, selected those individuals they suspected of sympathizing with the government, and shot them in cold blood as a lesson."

I don't raise that to prove the Contras are the bad guys. I think as long as you have this kind of struggle going on, you will have, whether we like it or not, incidents like that on almost any side, unless you are very civilized or very lucky.

I simply raise it to point out it is not enough for us to talk about who is good and who is bad. We have to ask the question how will the pressure which the Administration is asking us to apply through this aid actually work? Will it force the—will it topple the Sandinistas from power? Or if that isn't our goal, will it force them to change their cross-border activities, and will it force them to change their internal practices, including calling for new elections? Many of us doubt that it will, given the nature of the government we are dealing with down there.

Our question is, if it doesn't, what comes next? Our question is, if we provide this assistance to the Contras, and they wind up taking a military bath anyway because they still don't have enough resources or enough public support, you name it, what are we going to be asked to provide them? Are we going to be asked to provide more money? Are we going to be asked to provide technical and command help? Are we going to be asked to provide logistical aid?

We don't know. And that is one of the reasons that we are so skeptical about your policy.

Senator Lugar said something. He obviously doesn't agree with my position. But when we were at the White House last week, you will recall Senator Lugar told the President that generally it was good to see policies where you could have more than 51 percent of the American people or the American Congress supporting an Administration initiative.

He was speaking generically, but I would apply that specifically in this case, because it seems to me that the reason it is so essential for us to arrive at a different set of proposals for dealing with the Nicaraguan problem is because if we don't pursue a negotiated first track by getting in the driver's seat, so to speak, on the Contadora process, rather than being sort of in the rumble seat, we wind up, in my judgment, really crippling our ability to succeed, and crippling our ability to sustain policy over the long haul in this country.

We can't. And you may very well be able to win after a long, bitter fight your effort to get the $100 million out of Congress.

But I honestly don't think that that kind of narrow win is going to be strong enough to sustain you even if you do win, unless the country is agreed that not only your goals are correct, but also the process by which you are going to get to those goals makes sense and is a reasonable application of resources to obtain a common goal. That is what we have our doubts about.

I will grant you this: In one respect, I am happy to see the Administration make this request, because I do think that muddling along on this middle ground isn't getting us anywhere. I do honestly, intellectually believe that the country has to make a choice between either pursuing a straight-out negotiated effort as our first preference or else moving to a military approach, because what I am convinced of is that the longer we continue this middle ground, the longer we will simply have this border struggle that is a borderline struggle where we don't make progress, they don't—the other side doesn't make any progress.

We have a long, bitter war of attrition. I fear that sooner or later we will wind up on that slippery slope people are talking about to direct

Let me simply—again, on the other point—urge you to remember what I said earlier in the day. We can argue about how much this committee is going to provide. I can honestly tell you, Mr. Secretary, it is not what I want to see happen. But I honestly tell you as I walk around that House Floor every day, Members tell me, "Obey, I am not going to support foreign aid this year if it is at the expense of carving up things I stood for for five or ten years at home."

I am getting that kind of comment all around, from a wide variety of people, with a wide variety of philosophies.

You suggested that we don't want a tax increase. I am not supporting an individual tax increase; I am saying that we have got to have an agreement between the Administration and the Congress on a total comprehensive all-inclusive set of budget cuts, not just focused on that one gray section of the budget up on that chart.

We have also got to have, in my judgment, revenues, or we are not going to get to the deficit levels that we all want to get to.

I simply want to make the point that if we cannot get that deficit reduction through that combination, then please don't ask this committee to ignore the fact that we can't get the votes for what we bring out of committee. Don't ask us to support foreign assistance abroad financed either by gutting cancer research at home or by continuing to borrow, because that is not intellectually defensible, it is not politically defensible, and it is not in the best interests of the country.

So that is it. Would you like to respond? Please do.

Secretary SHULTZ. I feel somehow I have been responding all morning. It must be clear that we don't agree. I can go through it again, but I think—well, I won't.

Mr. OBEY. In that case, I do ask you to take seriously my request to submit to us a description of how you would distribute funds in this bill. If we meet the Middle East area of the budget at Gramm-Rudman levels and include $1 billion in economic and $1 billion in military assistance for other programs I think that is the most that the House will vote.

If any other member of the committee believes otherwise, I invite them to try to pass it on the Floor in the context of the budget cuts for everything else.

Thank you, Mr. Secretary.

## Questions From Congressman McHugh

*Question.* The Governments of Costa Rica and Nicaragua have been exploring ways to ease tensions along their common border, and other Latin American nations are examining how they can contribute to this process. In particular, there apparently have been discussions looking toward the formation of a Latin peacekeeping force to monitor the border between Costa Rica and Nicaragua. Would the U.S. support establishment of such a peacekeeping force if both the Costa Rican and Nicaraguan governments requested the establishment of such a force, and other Latin American nations agreed to do so?

Answer. The United States would support such a force as part of a verifiable and comprehensive regional settlement. From the outset of the Contadora process, we have made clear to all concerned our belief that bilateral, piecemeal agreements (i.e., implemented prior to a comprehensive agreement) will only undermine the effort to obtain a comprehensive, lasting settlement.

*Question.* Would the United States be prepared to fund a portion of the costs involved in maintaining such a peacekeeping force as it does elsewhere in the world?

Answer. We would be prepared to consider funding a portion of the agreement, provided that it is one element of a comprehensive settlement. We do not wish to encourage piecemeal agreements.

*Question.* On p. 24 of his prepared statement, the Secretary stated: "Nicaragua is the only non-democratic country remaining in that region" (referring to Central America). Was it the intent of the Secretary to characteristic Panama as a democracy?

Answer. Nicaragua is actively anti-democratic, whereas Panama is an open society. Panama progress toward stable constitutional order and unimpeded, fully-civilian political institutions was impaired by the failure and forced resignation of Nicolas Barletta and succession of his elected Vice President. Panama's sole armed military/police force, the Panama Defense Forces, acknowledge a continuing influence in political and governmental matters that we believe is undesirable for Panama's long-term political stability and development. But Panama's clearly pluralistic societal institutions, free-enterprise economy, the generally favorable socio-economic situation of its people, general freedom to express political dissent, functioning legislature and civilian judicial and executive organs, put Panama manifestly on the democratic side of this worldwide dichotomy. Panama's institutional setting would be fatal to the Sandinista regime; this is the essential element of distinction between them.

## EL SALVADOR—INDISCRIMINATE BOMBING

*Question.* Concerns continue to be raised that the Salvadoran armed forces engage in indiscriminate bombing against civilian non-combatants. Could you respond to that charge?

Answer. The policy of the Salvadoran Government is to avoid civilian casualties in both its ground and air operations against guerrilla organizations. In September 1984, President Duarte issued stringent guidelines on aerial combat operations requiring that the target of bombing be free of civilians, that the area be clearly visible to the pilot, and that permission to bomb be obtained from the General Staff in San Salvador. Salvadoran pilots are complying with these rules. Our Embassy in San Salvador closely monitors their performance; we are aware of numerous instances in which Salvadoran pilots have broken off combat because of the presence of civilians who might be endangered.

In the recent U.N. report on the situation in El Salvador, submitted to the General Assembly on November 5, 1985, the Special Rapporteur concluded that the "Salvadoran Army is endeavoring to conduct the war in a more humanitarian manner than in the past and is therefore not pursuing a policy of indiscriminate bombing, although in a few cases air and mortar attacks are causing civilian casualties."

*Question.* In his testimony this morning, Secretary Shultz expressed his concern about the reported involvement of the Sandinistas in cocaine trafficking. Yet, the same charge has been made about the contras. Is the Administration prepared to categorically deny that the contras have engaged in cocaine trafficking?

Answer. There have been allegations that the resistance is involved in drug trafficking, but these have never been proven. Some individual members of the resistance may have been involved in drug trafficking, but the leadership was not involved and did not condone this activity. This issue was raised at a recent meeting between Secretary Shultz and the democratic resistance leadership, and the leaders assured the Secretary that their organizations were not involved in the drug trade, and that anyone participating in drug trafficking would be punished.

*Question.* It has been reported that the Administration intends to notify Congress in the near future of its plan to sell approximately $300 to $350 million worth of air-to-air missiles to Saudi Arabia. What specific steps has Saudi Arabia taken in the last year to promote the Middle East Peace Process?

Answer. As you are aware, Congress was informed of the Administration's intent to sell Saudi Arabia additional AIM-9L, AIM-9P4, STINGER and HARPOON missiles with a total value of $354 million last week.

The Saudis gave quiet but useful support to the efforts, now failed, betwen King Hussein and the Palestinians to reach a common basis for negotiations. Throughout the past year's events, Saudi Arabia kept up its financial and crude oil assistance to Jordan and maintained its position that it was prepared to accept any agreement reached by the parties directly involved. Previously they had bucked vocal Syrian opposition in sending official observers to the Amman Palestine National Council meeting where moderate Palestinians made a decision to break with the radicals, and from which King Hussein launched his peace initiative. Saudi Arabia had earlier signaled its tacit support for King Hussein's moves to lay the foundation for peace negotiations by continuing its substantial financial assistance payments during the critical steps in the process, i.e., after Jordan resumed diplomatic relations with Egypt. Likewise, Egypt's return to the Organization of the Islamic Conference in early 1985 was significantly assisted by crucial Saudi support for a procedural motion calling for a secret ballot on the readmission vote. Finally, it is clear that the shift in Arab political focus from whether to how to make peace with Israel stems considerably from Saudi initiatives back in 1982 which led to the adoption of the Fahd Plan over the objections of the Arab militants.

*Question.* What additional costs would Israel have to incur to meet the potential threat posed by this sale, and what effect would that have on Israel's economic recovery program?

Answer. We do not believe the proposed arms sale to Saudi Arabia poses a threat either to Israel's security or to its qualitative military advantage in the region; accordingly, we do not believe the proposed sale requires any additional military expenditures by Israel.

*Question.* In his prepared statement, Secretary Shultz indicated that the economic reforms adopted by the Egyptian government to date "still fall far short of the comprehensive effort needed for long-term economic viability." What specific steps does Egypt need to take to insure its long-term economic viability?

Answer. The Egyptian government alone must decide on the measures needed to address its serious economic problems. The Egyptians' priority areas for action include reduction of the balance of payments and budget deficits, an improved system of debt management, and an expanded role for the private sector.

An illustrative list of specific measures Egypt could take would include:

Exchange rate reform; reduction of subsidies by limiting them to the truly needy; more market-related prices for electricity, energy products (natural gas, kerosene, gas, oil, and diesel fuels), and agricultural commodities; reduction of public sector employment; rationalization of public sector companies; increases in tax revenues; reduction in operating expenses of government agencies; rationalization of trade, including reform of customs and tariff policies; limitation of public and public-guaranteed short-term debt to existing levels.

The Egyptian government has already begun to implement many of these measues and others under active consideration.

*Question.* In view of the recent disturbances in Egypt, is it realistic to expect that the Egyptian government will take the additional steps that are needed?

Answer. The Egyptians have indicated to us that they plan to press ahead with their economic reform program despite the February disturbances. In a March 8 address to the People's Assembly, President Mubarak said he had ordered the cabinet to accelerate implementation of the government's economic program, calling for budget cutting, promotion of private sector growth, and improved performance by public sector companies.

In response to Mubarak's instruction, the cabinet was scheduled to meet March 18 in special session to act on a detailed set of measures. Prime Minister Lotfy promised these measure would be rapidly implemented and said the people would soon feel their effects.

*Question.* Has the South African government provided financial and/or military assistance to UNITA in the past? Is so, please describe the types and amounts of assistance it has provided?

Answer. South African Defense Minister Malan admitted last September that South Africa gives assistance to UNITA. We cannot comment on the amounts and type in open session because that falls into the area of sensitive intelligence matters.

*Question.* Is there any indication that its level of assistance to UNITA is declining?

Answer. We do not believe so. Indeed, South Africa's intervention on UNITA's behalf during last year's government offensive suggests South Africa considers UNITA's survival to be of utmost importance.

*Question.* Why hasn't South Africa's assistance contributed to a negotiated solution in Angola thus far?

Answer. The U.S. does not condone cross-border violence no matter who commits it. We publicly joined the international community in condemning the South African raids into Angola.

However, there is no doubt that South African aid to UNITA, along with aid UNITA gets from elsewhere and the resources it obtains within Angolan territory, contribute to its ability to deny the MPLA a military victory. We do not believe a military solution for either side is viable. A negotiated settlement on the independence of Namibia under UNSCR 435 and the withdrawal of Cuban troops from

Angola is the only way to attain real peace in Angola. If the Angolan government wants the South Africans out of Namibia, and therefore no longer on its southern border, it will have to agree to Cuban troop withdrawal. If it chooses instead to continue to try to solve its domestic problems by military means, it may cite reports of foreign assistance to UNITA as an excuse for retaining Cuban troops. But the real issue is whether the political will exists in Luanda to seek a negotiated regional settlement.

*Question.* How much assistance to UNITA would be needed, and for how long a period of time, to contribute to a negotiated solution?

Answer. We do not know how much foreign assistance UNITA receives. However, UNITA is a guerrilla movement. Therefore its needs are not the same, in degree or type, as a conventional army.

We view with sympathy UNITA's struggle against Soviet/Cuban adventurism. UNITA is a true nationalist movement with legitimate aspirations of having a voice in Angola's political future. We believe that appropriate and effective support should be provided to UNITA. But as we have said before, our policy for Angola/Namibia is based on the understanding that military solutions are not viable. Our efforts are focused on the need to achieve a negotiated settlement on the independence of Namibia under UNSCR 435 and in that context the withdrawal of Cuban troops from Angola. The withdrawal of foreign forces from Angola and Namibia will help the Angolans work out a solution to their internal problems themselves.

*Question.* Is it true that our goal in Angola is a negotiated solution, not a military victory by UNITA?

Answer. Yes.

*Question.* Would any U.S. assistance provided to UNITA be designed to supplement or to substitute for South Africa's assistance?

Answer. As a general matter, I cannot go into this sort of subject. Let me reiterate, however, that we believe UNITA to be a true nationalist movement with legitimate aspirations of having a voice in Angola's political future. As we understand it, UNITA already receives important support from non-South African sources, including other African countries and some in Western Europe.

*Question.* In his testimony Secretary Shultz stated that the non-communist resistance forces "have some 9,000 troops currently operating inside" Cambodia, "with more scheduled to enter." Please describe what military successes the non-communist resistance forces have achieved to date. For example, how much territory do they control within Cambodia and how much of the population is under their control?

Answer. It is important to keep in mind that the goals of our assistance to the non-communist Cambodian resistance forces are not strictly military. We are trying, along with our friends in the Association of Southeast Asian Nations (ASEAN), to help efforts that build up the non-communists as a viable political alternative to both the Vietnamese and the Khmer Rouge. At the same time, we, ASEAN and others want to add to the pressure on the Vietnamese to negotiate a settlement in Cambodia. While there is a military component to both these objectives, success in achieving them cannot be measured in military terms alone.

When the non-communist resistance groups were first formed about five years ago, they each had only a few hundred troops under their control. Today, the Khmer Peoples National Liberation Front (KPNLF) armed forces total some 10–15,000 armed men, and the Sihanoukist National Army (ANS) numbers about 9,000. This is a remarkable achievement considering the resistance controls virtually no Cambodian territory and fewer than 200,000 people in temporary refugee camps along the Thai-Cambodian border.

*Question.* How does their military performance compare with that of the communist resistance forces?

Answer. The Khmer Rouge have been engaged in guerrilla warfare since 1970, and they are very good at it. The non-communists have a long way to go before they can match the capabilities of the Khmer Rouge.

The non-communist forces total some 20–24,000 men, compared with 35–40,000 for the Khmer Rouge. The Khmer Rouge have battle-hardened military leaders and troops disciplined by the experience and the threat of terror. The non-communists are as well-armed as the Khmer Rouge on a per capita basis, particularly with the small arms which are most appropriate to guerrilla warfare. The non-communists are also receiving extensive military training.

Nonetheless, the non-communist military capabilities and performance are much lower than the Khmer Rouge.

Led by the popular Prince Sihanouk and not saddled with Khmer Rouge record of atrocities, the non-communists have considerably more popular support inside Cambodia than either the Khmer Rouge or the Vietnamese. This is their greatest strength and their hope for the future.

Most of the efforts of the non-communists are devoted to building a guerrilla infrastructure and popular support in the interior of Cambodia, not attacking the far superior Vietnamese army (140,000 men). Nonetheless, the non-communists have succeeded in harassing the Vietnamese and inducing soldiers, sometimes in whole units, to defect from the puppet Phnom Penh army.

In combination with the Khmer Rouge resistance forces, the non-communists have been able to deny the Vietnamese consolidated control of the Cambodian countryside and to render a large percentage of the country insecure and vulnerable to attacks on roads, railroads and military facilities.

*Question.* The Secretary mentioned that he plans to visit Greece and Turkey in the near future. What is the purpose of his trip?

Answer. The purpose of the Secretary's visit to Turkey and Greece is to continue the process of improving and strengthening relations with these two important NATO Allies. He will meet with high level government officials and political leaders in the two countries, and will discuss the entire range of bilateral and multilateral issues.

In Turkey, he will discuss the renewal of our Defense and Economic Cooperation Agreement (DECA), our economic and trade relations, and will exchange views on the Middle East and East-West questions, among other issues. In Greece, he will discuss the future of our bases, and terrorism. He will discuss Cyprus in both countries.

*Question.* Does the Secretary plan to discuss the continuing Turkish occupation of Cyprus with the Turkish government?

Answer. The presence of Turkish forces on Cyprus cannot be separated from other aspects of the Cyprus problem, particularly the question of security guarantees for the Turkish Cypriot community. The Turkish Government has said that Turkish forces will be withdrawn from Cyprus in the context of an overall settlement. We believe that the best avenue for achieving progress toward the resolution of the Cyprus issue is the U.N. Secretary General's current initiative. The Secretary will urge both Turkey and Greece to support the Secretary General as he takes his next step in this process.

*Question.* Does the Secretary plan to put forward any specific suggestions regarding a resolution of the Cyprus conflict?

Answer. The Secretary will urge Turkey and Greece to give their full support to the Cyprus initiative of the UN Secretary General.

WEDNESDAY, MARCH 5, 1986.

## AGENCY FOR INTERNATIONAL DEVELOPMENT

### WITNESS

M. PETER McPHERSON, ADMINISTRATOR OF AID

### CHAIRMAN'S STATEMENT

Mr. OBEY. If we could begin this morning, yesterday the subcommittee held its first hearing on the review of the Administration's foreign assistance spending request for the Fiscal 1987 budget.

This morning, we will hear from the Administration's lead witness on the economic side, yesterday we heard from Secretary Shultz, who gave us his overview of the Administration's budget request.

Tomorrow we will hear from Mr. Schneider, who will lay out for us the Administration's security and military request, and this morning we have with us Mr. Peter McPherson, Administrator of AID who will lay out for us the non-bank economic assistance request of the administration for this fiscal year.

Mr. McPherson, I should have said so yesterday when both you and Bill Schneider were before us with Secretary Shultz. I didn't, but I will say when Bill is here tomorrow, also—we may have a lot of professional differences in terms of the content of the Administration's budget, but I do want to state I regard both you and Mr. Schneider to be first rate human beings and first rate public servants and first rate professionals.

I hope people will understand that our differences, when we have them—and a lot of times we have agreements, too, I should point out—but I hope people will understand that our differences, when we have them are professional, not personal, and I am sure you know that.

As you know, I regard many of the programs which you administer as being among the top priority in our foreign assistance program.

I certainly feel the nutrition programs, children's health programs, programs like that, and the projects which you oversee which attempt to assist Third World countries in developing their own economies, are useful and essential.

The problem, as I laid out to Secretary Shultz yesterday, is that within the context of the budget presented by the Administration which cuts quite severely the number of domestic programs, we are being asked to increase the military budget; we are being asked to increase the foreign assistance budget, excluding the Ex-Im Bank by about $2 million over last year's levels after Gramm-Rudman went into effect.

Leaving aside the question of whether that increase is justified on the merits, if we look at it in a perfect world where we didn't have to worry about how we are going to have to pay for it, the problem we have and what I am trying to do, is simply to allow, again, not my personal preferences but the problem I have as a committee chairman trying to bring this before—those problems, I think, are best exemplified by a report from the Congressional Budget Office last—several months ago.

The CBO pointed out that if we look at domestic discretionary programs, that in 1982, before we ever even heard of the Great Society, that in 1982, the share of the national—the share of our national resources, the share of our gross national product which went to domestic discretionary programs was about 4.2 percent. That rose to a high of about 5.8 percent in 1979 and 1980.

It has now declined to the point where we are voting 4.1 percent of our gross national product to domestic discretionary programs, and those are programs for education, for health, things like that here at home, not the entitlement programs.

If we don't even consider the President's budget, if we just continue on automatic pilot, based on the decisions the Congress made last year, we will see those domestic discretionary programs decline as a percentage of our total national output, 2.3 percent of our total GNP.

If we pass the President's budget, we would see that portion of our national resources devoted to domestic discretionary programs. That declines to 2.7 percent of our gross national product, 30 percent lower as a share of GNP than they were before we decided we had a problem and needed to do something about it in the 1960's.

That is the context in which we are considering your budget and Mr. Schneider's budget and Baker's under the Treasury portion of this bill, and that is why it is going to be very difficult to get any kind of support for a foreign aid bill this year, because as everyone understands, under Gramm-Rudman we can't fold into a continuing resolution. We have to deal with it as an appropriation bill on the Floor before the July holiday, the July 4th holiday.

So, at the risk of boring people with a lecture which I gave at some greater length yesterday, that is our problem in considering the request.

Frankly, in terms of the increase in the budget being requested by the Administration, if we compare the three areas, your programs would probably be the star in comparison to the other two groups of programs under what is loosely called "foreign aid".

In fact, if you look at what has happened since 1981, we have had for all military aid programs—we have seen an increase from $3.2 billion, roughly, to about $6.7 billion in the Administration's request for this year, which amounts to 111 percent increase, more or less. For MAP programs, which are the grant military programs, they go from $110 million in 1981 to $1,046 million in the President's request this year, which is an 850 percent increase since 1981 for the give-away military assistance.

In contrast, for programs on the development side, both bilateral and multilateral, we have approximately $3.6 billion in 1981. In 1987 we are being requested to approve $4.3 billion. That is an increase of roughly 19 percent. Much smaller.

I am simply trying to lay out what the numbers are under ESF which are funds which we provide for development purposes, to countries with high defense burdens, high security burdens—we have seen a 95 percent increase, from $2.1 billion to $4.1 billion requested in 1987.

Anyway, your programs have seen the smallest increase. I would like to reverse the mix and see you get a larger share of the total aid pot.

Frankly, as you know, this year that is going to be difficult. So, I would simply ask you to say in your testimony whatever you would like, and give us some idea of what your highest priorities will be. Because as I indicated to the Secretary yesterday, while I strongly consider simply funding our Middle East programs at roughly the Gramm-Rudman level, unless we get a budget compromise which allows us to do more, and then simply saying on the military side and on the economic side what would we do with the billion dollars each.

We would like to talk today with reference to what your highest priorities are. Be frank with us about what you think your needs are substantively, but let us know also what you think represents your higher priority versus lower priority items, so we don't have to make reductions we don't want to make because of overall budgetary constraints.

Before you begin, let me turn to Mr. Kemp for whatever comments he might want to make.

## STATEMENT OF MR. KEMP

Mr. KEMP. Thank you, Mr. Chairman.

I am not going to make much of an opening statement other than to welcome Mr. McPherson. I agree with you, Dave; both Mr. McPherson and Bill Schneider are capable and honorable representatives of the United States and the State Department in this Administration.

I join in welcoming Peter today, and Mr. Schneider, as you said, will be here tomorrow.

Having said that and having read through the testimony, I am looking forward to the candor you would expect of all the witnesses, Mr. Chairman.

I just would like to say to Peter that I think the Chairman has outlined probably some of the realities of the budget constraints, both from his side of the aisle and from our side of the aisle.

Notwithstanding that, as I said to Secretary Shultz yesterday, I think our priorities in foreign aid need to be put in the perspective of what the threat is, what some of our allies and friends face, the necessity in building bridges to the rest of the world and strengthening alliances; indeed, strengthening the economies.

You point out, I think, in page one of your statement, a strong U.S. economy is essential to economic progress throughout the developing world.

That is true, but it is equally true that a strong economy in the developing world is essential to economic progress in the United States.

It may come as a surprise to some, but I agree with President Kennedy who said, while being dependent we are interdependent.

We are dependent on the developing world for markets to absorb 50 percent—to be frank, to be more specific, I think, it is more than 40 percent of all our exports, so we have a big stake in the developing world.

I want to applaud your efforts to rethink those years of austerity through which some of them have been pushed, unfortunately, by some of our own policies, as well as the multilateral policies of the IMF.

Bill Raspberry wrote an interesting column recently in the Washington Post saying we make virtually no effort to export the American economic system.

It is as though we doubt our economic system will work in the Third World. You and I have had this talk before, and I won't belabor your testimony with my views about Third World development, but it seems to me there should be greater focus on policies that can bring Third World developing countries towards the type of growth which have produced their tremendous servicing the debt cost, help them provide expanded markets for U.S. goods, and bring down those high unemployment rates that are destabilizing, not only economically but politically, and give us, frankly, a better shot, a better chance, if you will, of offsetting this chance of Communism.

I don't think anti-Communism, per se, is an answer to the threat of Communism in the Third World or Socialism, if you will. The only answer is to pursue policies that will provide both democratic government aid and, of course, development policies.

I would like to applaud the efforts you are making to refocus attention on economic development. I wouldn't be me if I didn't find someplace to be critical, and I am critical that not enough has been done in the past. And, apparently, in your testimony you are not focusing, in my view, enough on these destabilizing effects of very high interest rates, very high tax rates, austerity policies that are still being pursued by some of our friends of which you have, if not control of, at least influence on.

But I will save my questions until after your testimony and look forward to that same candor that the Chairman has asked for and that you are associated with in your services as our Director of AID.

Welcome.

Mr. OBEY. Please proceed, Mr. McPherson.

### OPENING STATEMENT OF MR. MCPHERSON

Mr. MCPHERSON. Mr. Chairman, thank you. It is good to be before this committee once more.

I appreciate your comments. I feel that this committee and AID have had a very productive and candid relationship, and we appreciate that. We would like to continue in that spirit.

I think the best way to approach this this morning is to let me enter my comments into the record and make some focused comments rather than go through the discussion that you and Secretary Shultz had at length yesterday.

We clearly have heard you. I have discussed the matter since then and will be continuing to talk about it with the subcommittee, as you know.

As a basis of making clear that we have heard you, and in thinking about all these matters, let me say that we think that this economic assistance program, is one that benefits America economically as well as in other ways.

The growth in the Third World is, in fact, a creator of jobs for this country. We used to talk about Europe being an engine for the world economy or for the U.S. economy.

Of course, what has happened is that we now have portions, of the Third World acting as either engines or drags upon the world economy.

The Third World has become significant to the whole economy. It is obvious that the foreign aid program is an integral part of our linkages to this world.

Our discussions with governments are key elements of our business, as evidenced in our talks with the Philippines and as we try to figure out how we are going to proceed in Haiti, and throughout the rest of the world.

When you look at our program and you think about it versus the general concept of foreign aid, and then ask the American public what they think of foreign aid—the feedback is overwhelmingly negative.

It is too bad we can't change the name somehow, because when you break down the individual components, what I would call the building blocks of foreign assistance, each component has major congressional support, such as the ORT program—which has, in fact, enormous importance to America and a great deal of support.

We have pruned back those things, I think, largely, if not completely, which are not so critical. The critical elements like our Middle East assistance, are strongly supported by this subcommittee.

Another critical component, Central America, receives about one billion dollars; the base rights, and military access states receive another billion dollars. our humanitarian assistance which goes to places like Bangladesh and parts of Africa, is also strongly supported by Americans.

In fact, this subcommittee is especially interested in African assistance.

Mr. KEMP. How much is it, generally speaking?

Mr. MCPHERSON. What I would classify as humanitarian assistance, is about $850 million. Our centrally funded program adds even more.

That includes everything from malaria research, which really has begun to pay off, to agricultural research that is beginning to pay off handsomely, as well.

For example, in Sudan, we have a new variety of sorghum which produces twice the historical yields, as a result of agricultural research, which is now being transferred. When you add up the various components: DA, ESF and PL 480 you quickly get to about $7 billion, and it is very difficult to see how we can trim any of those components down.

Now, we understand we live in a difficult budgetary world like everyone else, and we continue to struggle with this. I think I make more use out of every dollar you give me because austerity has forced us to be very imaginative.

Having talked about that basic concept, let me emphasize very briefly some things which I think are especially exciting and/or very important.

There are about 14 million children five or under, who die in the Third World each year. There has been a lot of discussion on the Hill and around recently about immunization, because about 3.5 million of those children die from diseases from which virtually no Americans—illnesses like measles and tetanus that the immunizations, which are inexpensive—pennies—can prevent.

Now, not as emphasized, but frankly, something which the U.S. has had a very major role in reversing, is death resulting from dehydration caused by diarrhea. This kills about 4 million children a year. I have brought some pictures you may want to look at.

I think the pictures are being passed around. Most of you have heard about this, and I have seen examples of this all over the world. This is a picture of a child at 9:00 o'clock in the morning, within hours of death because of dehydration, and by early afternoon the child is sucking at the mother's breast and is going to live. ORT works.

By the way, cholera is just an extreme form of diarrhea. All the cholera epidemics we have heard about throughout history could have been prevented had they known about this. This was first tried out in the cholera epidemic in India.

Now, WHO and UNICEF had a major conference which we sponsored in this country a few months ago where about a thousand people from different countries came. We got together and agreed on what we call the twin engine approach.

The World Bank was involved, as well. Really, the major players from around the world have come together in this effort to reduce child mortality and agreed upon an approach.

It is not just immunization, but ORT as well. I think this is something we need to continue to emphasize.

Mr. **Kemp**. I think everybody here would agree that you and AID and WHO have really done a magnificent job in this area and are to be commended.

It was really an initiative that was at least expanded by you, and all of us applaud the effort being made.

I certainly want to.

Mr. **McPherson**. It is really exciting. In Egypt last year, as a result of what we began in 1983, we saved 90,000 children last year.

Everybody from President Mubarak down to—our surveys show—90 percent of the women in Egypt know about ORT. And there is no reason why we can't continue to have that kind of impact.

Now, as we move on this, we realize that money isn't the only answer to this. It is my understanding in talking to President Mubarak, and talking to other leaders, that money isn't the whole answer. And I hope we don't exchange other components of our program for this component, just because the other components don't have as much public pizzazz.

For example, in the agricultural area we have been able to do some really very, almost amazing things. I mentioned sorghum a minute ago. We need to have a green revolution in Africa, and we are putting substantial resources into doing that.

It is a long-term effort, but we now have a casaba, which is a potato-like plant which produces about a thousand percent more casaba for west Africa.

I want to focus attention on the agricultural component as well as on the health one. We have also asked for a substantial amount of money here for our 106 account, selected development activities which includes private sector activities.

We are beginning to get some things going in the private sector that I believe are really paying off.

I have seen those export-oriented industries in Haiti which were involved in our program. I feel that our efforts here are key to the kind of growth that creates jobs. When I talk to people about the private sector, I talk about market forces and, essentially, job creation. That is what people want to hear.

Jobs, in the end, are the way to satisfy basic human needs. Jobs create income to buy medicine, to buy food and housing, etc. This subcommittee has been very interested in family planning issues.

I recently gave a speech to a symposium where I laid out our approach to family planning, and frankly, I feel very good about it and got really excellent responses to it.

What I said there was, "let's set aside the issue whether or not population impacts upon economic growth, since there is a lot of dispute about that issue. Let's go back to the basics."

Mr. **Lewis**. Excuse me.

I wondered if it wouldn't be wise to delay that area. John is going to be back.

Mr. **McPherson**. That is a good point. Let me make one last point and I will welcome your questions.

I put a lot of emphasis in the last few years on participant training. In 1981 we had between 7,000 and 8,000 people we brought to the United States to be trained.

This year we will have about 15,000 people we will bring to this country for training, which represents a steady increase over the years.

I think in the end that participant training pays off more for America than almost anything we do, both in terms of relationships with the Third World as well as in the substantive strength that Third World countries gain through human resource development because the foundation of growth in countries depends upon having capable human resources there, and so, accordingly, we have put some real stress on this.

Mr. Chairman, it is good to be here, and I look forward to your comments and questions.

Mr. **Obey**. Yes. Thank you.

[The statement of M. Peter McPherson follows:]

STATEMENT OF
M. PETER MCPHERSON
ACTING DIRECTOR
INTERNATIONAL DEVELOPMENT COOPERATION AGENCY
AND
ADMINISTRATOR
AGENCY FOR INTERNATIONAL DEVELOPMENT
BEFORE THE
HOUSE APPROPRIATIONS COMMITTEE
SUBCOMMITTEE ON FOREIGN OPERATIONS

MARCH 5, 1986

MR. CHAIRMAN, I AM VERY PLEASED TO APPEAR AGAIN BEFORE THE HOUSE APPROPRIATIONS COMMITTEE TO DISCUSS THE ADMINISTRATION'S FY 1987 PROPOSED PROGRAM IN FOREIGN ECONOMIC ASSISTANCE. WE WELCOME THIS OPPORTUNITY TO PRESENT THE PROGRAM OF DEVELOPMENT AND ECONOMIC AID TO THIS COMMITTEE WHICH HAS TAKEN SUCH A KEEN INTEREST IN OUR ASSISTANCE EFFORTS THROUGHOUT THE WORLD.

THE BUDGET THAT WE ARE SUBMITTING THIS YEAR HAS BEEN PREPARED WITHIN THE CONTEXT OF THE GRAMM-RUDMAN-HOLLINGS LEGISLATION AND THE EFFORT BY THE CONGRESS AND THE ADMINISTRATION TO ADDRESS EFFECTIVELY THE DEFICIT PROBLEMS WHICH FACE THIS COUNTRY. A STRONG U.S. ECONOMY IS ESSENTIAL TO ECONOMIC PROGRESS THROUGHOUT THE DEVELOPING WORLD. OUR REQUEST, AS PART OF THE PRESIDENT'S BUDGET, IS CONSISTENT WITH

THE PLAN THAT THE FEDERAL DEFICIT SHALL NOT EXCEED $144 BILLION IN FY 1987. THE DEVELOPMENT ASSISTANCE PART OF OUR REQUEST, AT $2.1 BILLION, IS A 4 PERCENT INCREASE OVER THE FY 1986 POST-SEQUESTRATION LEVEL UNDER GRAMM-RUDMAN-HOLLINGS, BUT 1 PERCENT BELOW THE FY 1986 REQUEST LEVEL, AND APPROXIMATELY 13 PERCENT BELOW THE FY 1985 LEVEL. FOR PL 480, AN IMPORTANT PART OF THE DEVELOPMENT EFFORT, LEVELS IN THE PRESIDENT'S BUDGET ARE BELOW THOSE IN FY 1986 BUT WE EXPECT TO BE ABLE TO SHIP APPROXIMATELY THE SAME AMOUNT OF FOOD AS CONTAINED IN OUR FY 1986 REQUEST. THE ESF LEVEL OF $4.1 BILLION REPRESENTS AN INCREASE OVER FY 1986 POST-SEQUESTRATION LEVELS TO HELP PROVIDE NEEDED ASSISTANCE TO COUNTRIES IN CENTRAL AMERICA AND AFRICA WHICH WERE REDUCED AS A CONSEQUENCE OF REDUCED APPROPRIATIONS, EARMARKS FOR OTHER COUNTRIES AND GRAMM-RUDMAN-HOLLINGS SEQUESTRATION IN FY 1986.

THE ECONOMIC ASSISTANCE PROPOSAL WE HAVE SUBMITTED IS CAREFULLY STRUCTURED. IT WAS DEVELOPED WITH FULL RECOGNITION OF THE IMPORTANT AND DIFFICULT CHALLENGES WHICH THIS COUNTRY FACES IN GETTING ITS ECONOMIC HOUSE IN ORDER. WE BELIEVE THE PROGRAM WE ARE SUBMITTING IS CONSISTENT WITH OUR BEST NATIONAL INTERESTS -- IN POLITICAL, ECONOMIC AND HUMANITARIAN TERMS.

WE HAVE BROUGHT ABOUT CHANGES IN THE AID PROGRAM THROUGH A GREATER EMPHASIS UPON THE USE OF MARKET FORCES AND THE PRIVATE SECTOR, THROUGH A STRONG DEDICATION TO POLICY REFORM, THROUGH INCREASED ATTENTION TO TECHNOLOGY TRANSFER AND THROUGH A

HEIGHTENED AWARENESS OF INSTITUTIONAL DEVELOPMENT -- FOUR PILLARS OF CHANGE -- WHICH HAVE IMPROVED AMERICA'S EFFORT IN THE TASK OF HELPING COUNTRIES MEET BASIC HUMAN NEEDS AND ACHIEVE GROWTH THAT IS SELF-SUSTAINING AND EQUITABLE. THIS COUNTRY CAN BE PROUD OF ITS IMPORTANT ROLE IN DEVELOPMENT EFFORTS. IT IS SOMETHING UNPARALLELED IN HISTORY. THE ASSISTANCE WE ARE PROVIDING IS AFFECTING MILLIONS OF LIVES THROUGHOUT THE WORLD.

A STRONG JUSTIFICATION IS REQUIRED FOR A SUBSTANTIAL FOREIGN ASSISTANCE PROGRAM THIS YEAR, PARTICULARLY IN THE FACE OF CUTBACKS THAT WILL TAKE PLACE IN OTHER AREAS. WE ARE FULLY PREPARED TO MAKE THAT JUSTIFICATION. WE BELIEVE THAT WHAT WE ARE SUBMITTING IS A MINIMUM PROGRAM. THE UNITED STATES CONTINUES TO BE FACED WITH DIFFICULT CHALLENGES THROUGHOUT THE WORLD AND THE ECONOMIC ASSISTANCE PROGRAM IS A CRITICAL PART OF AMERICA'S RESPONSE TO THOSE CHALLENGES.

THE PROGRAM LEVELS THAT WE ARE PROPOSING WERE CAREFULLY DEVELOPED AS PART OF AN INTEGRATED BUDGET PROCESS WORKING WITH THE STATE DEPARTMENT AND OTHER AGENCIES. WE HAVE CUT BACK AND STREAMLINED. IN FACT ONE OF THE MAJOR THEMES I HAVE EMPHASIZED DURING MY TENURE AS ADMINISTRATOR OF THIS AGENCY IS THE NEED TO FIND WAYS OF CARRYING OUT OUR BUSINESS MORE EFFICIENTLY. WE HAVE EMPHASIZED IMPORTANT CONTRIBUTIONS THAT CAN BE MADE IN TECHNICAL AREAS TO BRING ABOUT FUNDAMENTAL CHANGE IN THE ECONOMIES AND INSTITUTIONS OF MANY OF THE DEVELOPING

COUNTRIES. IN MANY COUNTRIES, HOWEVER, THE ECONOMIC SITUATION IS SUCH THAT BALANCE OF PAYMENTS ASSISTANCE THROUGH COMMODITY IMPORT PROGRAMS AND OTHER NON-PROJECT ASSISTANCE PROGRAMS IS ESSENTIAL TO HELP STABILIZE ECONOMIES WHILE STRUCTURAL REFORMS ARE TAKING PLACE. A LASTING IMPACT ON BASIC HUMAN NEEDS OF POOR PEOPLE IN DEVELOPING COUNTRIES CANNOT BE ACHIEVED IF THEIR ECONOMIES RETROGRESS.

WE HAVE EMPHASIZED IN OUR REQUEST THE MAJOR FOREIGN POLICY PRIORITIES OF THIS ADMINISTRATION. THE MIDDLE EAST PEACE PROCESS CONTINUES TO BE AN ESSENTIAL AND CRITICAL PART OF OUR GOVERNMENT'S FOREIGN POLICY AND A SUBSTANTIAL AMOUNT OF THE ECONOMIC AID REQUEST IS DIRECTED TOWARD THAT OBJECTIVE. WE ARE PROVIDING STRONG SUPPORT TO EFFORTS IN CENTRAL AMERICA TO STRENGTHEN DEMOCRACY AND ESTABLISH HEALTHY ECONOMIES AND PEACEFUL SOCIETIES. WE ARE SUPPORTING THE EMERGING DEMOCRACIES OF SOUTH AMERICA. ASSISTANCE IS ALSO DIRECTED TO COUNTRIES OF STRATEGIC IMPORTANCE TO THE UNITED STATES IN THE PERSIAN GULF AND SOUTHEAST ASIA. AND WE CONTINUE TO PROVIDE STRONG SUPPORT TO THOSE PORTIONS OF THE GLOBE WHERE BASIC HUMAN NEEDS ARE GREATEST -- IN AFRICA AND SOUTH ASIA.

THIS ADMINISTRATION HAS GIVEN GREATLY INCREASED ATTENTION TO MARKET FORCES AND THE PRIVATE SECTOR. WE HAVE ESTABLISHED A PRIVATE ENTERPRISE BUREAU, AND IN OUR REQUEST WE HAVE INCREASED FUNDS FOR THAT BUREAU. WE ARE REQUESTING FUNDING FOR THE REVOLVING LOAN FUND TO BRING IT TO THE FULL AUTHORIZED LEVEL.

But, of course, our private sector initiative is more than just financing the programs of one specialized Bureau; it involves a strong emphasis upon private enterprise in our total program.

In many countries we have seen progress toward greater privatization with increased emphasis upon the marketplace. In fact, privatization of government services is a growing theme in the developing world. Last year the Asian Development Bank held a conference on privatization. In May, the African Development Bank will do the same. And earlier this month, AID sponsored its own International Conference on Privatization where over 500 participants discussed many techniques of transferring economic power from the state to the people, while improving economic productivity at the same time. AID currently is helping recipient countries design privatization programs and will increase our assistance in this area during 1986 and 1987.

In Bangladesh the efforts that we have made have led to a much greater involvement of private enterprise in the agriculture area. A key element has been the increased reliance upon the private sector in distribution of fertilizer to the farmers.

We also have made a concerted effort to encourage private enterprise development in Egypt through projects providing credit to businesses for start-up and improvement of facilities. The first use of fund resources was a $5 million

LOAN TO GENERAL MOTORS EGYPT FOR CONSTRUCTION, EQUIPMENT AND TECHNICAL SERVICES NEEDED TO MANUFACTURE LIGHT AND MEDIUM-DUTY TRUCKS AND BUSES. LOCAL BANKS CO-FINANCED A LOCAL CURRENCY LOAN OF $30 MILLION. WHEN THE PLANT REACHES FULL PRODUCTION CAPACITY, IT WILL PRODUCE 18,000 VEHICLES PER YEAR AND EMPLOY 1,400 EGYPTIANS IN MANAGEMENT, TECHNICAL, AND BLUE-COLLAR JOBS.

AS PART OF OUR PRIVATIZATION EFFORTS WE HAVE GIVEN A GREAT DEAL OF ATTENTION TO ENCOURAGING RECIPIENT COUNTRY GOVERNMENTS TO MOVE AWAY FROM RELIANCE ON PARASTATALS AND TO GIVE A GREATER ROLE TO THE PRIVATE SECTOR. ONE SUCH EXAMPLE IS IN COSTA RICA, WHERE AID IS ASSISTING THE GOVERNMENT TO DIVEST THE ASSETS OF CODESA, THE COSTA RICA PARASTATAL HOLDING COMPANY. THE HOLDING COMPANY, WITH EIGHTEEN SUBSIDIARIES RUNNING HUGE LOSSES WITH THE CENTRAL BANK, REACHED A POINT WHERE IT WAS DRAINING ONE-THIRD OF COSTA RICA'S PUBLIC SECTOR CREDIT, WHILE GENERATING LESS THAN ONE AND ONE-HALF PER CENT OF GNP, AND LESS THAN ONE-HALF OF THE COUNTRY'S EMPLOYMENT. THE PRIVATIZATION PROCESS OF CODESA WAS BEGUN UNDER PRESIDENT MONGE, COMPLETE WITH LEGISLATION AND A BIPARTISAN NATIONAL COMMISSION ESTABLISHED TO PUT THE CODESA COMPANIES UP FOR PUBLIC BID. THE PROCESS IS FULLY UNDERWAY, WITH A GROUP OF PRIVATE BUYERS NOW BEING IDENTIFIED TO PURCHASE THE LARGEST COMPANY, THE ALUMINUM COMPANY, WITHIN APPROXIMATELY NINETY DAYS. WE ARE CONFIDENT THAT THIS IS MERELY THE BEGINNING OF THE ENTIRE DIVESTITURE AND WE EXPECT THE BULK OF CODESA'S ASSETS TO BE PRIVATIZED OR LIQUIDATED BY THE END OF THIS YEAR.

THE EMPHASIS ON THE PRIVATE SECTOR IS CLOSELY RELATED TO THE QUESTION OF POLICY REFORM. THIS ADMINISTRATION HAS STRESSED THE IMPORTANCE OF POLICIES WHICH ARE CONSISTENT WITH ECONOMIC PROGRESS. THE POLICY CLIMATE MUST BE SUCH THAT MARKET FORCES CAN EFFECTIVELY INTERACT -- THAT THERE IS AN INCREASING RELIANCE ON THE INDIGENOUS PRIVATE SECTOR AND ON FOREIGN INVESTMENT. GREAT STRIDES HAVE BEEN MADE IN THIS AREA. WE, OF COURSE, WORK WITH OTHER DONORS AND WITH THE MULTILATERAL INSTITUTIONS AS APPROPRIATE. THE CONCEPT OF POLICY REFORM HAS GROWN THROUGH THE PAST FEW YEARS SO THAT IT IS FULLY ACCEPTED WITHIN THE INTERNATIONAL DEVELOPMENT COMMUNITY WHEREAS IN THE PAST, IT WAS A MUCH MORE ISOLATED PHENOMENON. I THINK THIS IS REAL PROGRESS THAT WE CAN REPORT TO THIS COMMITTEE AND TO THE AMERICAN PEOPLE.

AS A PART OF OUR EMPHASIS ON POLICY REFORM, WE HAVE IN OUR ESF REQUEST $75 MILLION FOR A CONTINUATION OF THE ECONOMIC POLICY REFORM PROGRAM IN AFRICA, WHICH IS DESIGNED TO HELP BRING ABOUT POLICY CHANGES. SOME SPECIFIC EXAMPLES ARE OUR PROGRAM IN SUPPORT OF AGRICULTURAL MARKETING LIBERALIZATION IN ZAMBIA, WHICH IS ALLOWING PRIVATE TRADERS TO PARTICIPATE IN MAIZE MARKETING ON A BROAD SCALE AND WHICH, COUPLED WITH RECENT INCREASES IN PRODUCER PRICES, WILL HELP MOVE ZAMBIA FROM BEING A MAIZE IMPORTER TO SELF-SUFFICIENCY. ANOTHER EXAMPLE IS IN MALAWI, WHERE AS PART OF A MULTI-DONOR EFFORT IN STRUCTURAL ADJUSTMENT, WE ARE SUPPORTING THE REMOVAL OF FERTILIZER subsidies while simultaneously shifting to more cost-efficient, concentrated fertilizers so that agricultural production does not decline. And in Costa Rica, our policy dialogue has supported a major turnaround in that country's economic policies. The government budget deficit has been reduced from 14 percent of gross domestic product to 1.5 percent, while a more favorable exchange rate system has sharply increased incentives for exports. As a result, exports to the U.S. of non-traditional products increased from $114 million in 1983 to an estimated $172 million in 1985.

We are also using our PL 480 resources to provide leverage for our policy dialogue efforts. In Tunisia, the mission has encouraged the distribution of fertilizers by private agricultural input dealers. Traditionally, fertilizer was sold by inefficient parastatals, with little private sector involvement due to the narrow margin on sales. As a result of successful dialogue in conjunction with a PL 480 Title I self-help agreement, the Tunisian Government increased the sales margin on fertilizers so that by 1984 there were some 168 private enterprises involved. Recent increases in agriculture production, including the 1984-85 record cereals harvests, can be directly traced to farmers now having fertilizer on time.

*Technological transfer* is also an area which this Administration has strongly emphasized. I am personally committed to emphasizing bio-medical research to bring about

SCIENTIFIC BREAKTHROUGHS IN THE FIELD OF HEALTH. SIMPLE TECHNIQUES SUCH AS ORAL REHYDRATION THERAPY ("ORT") CAN HAVE A TREMENDOUS IMPACT ON CHILD SURVIVAL. WE ARE MAKING BREAKTHROUGHS IN THE DEVELOPMENT OF A MALARIA VACCINE AND IN THE DEVELOPMENT OF OTHER NEW AND IMPROVED VACCINES AND TECHNOLOGIES FOR DELIVERING IMMUNIZATIONS.

WE CONTINUE STRONG SUPPORT FOR AGRICULTURE RESEARCH EFFORTS THROUGH THE INTERNATIONAL RESEARCH INSTITUTIONS. THERE ARE PARTICULARLY PRESSING NEEDS IN AFRICA, WHERE FOOD PRODUCTION MUST BE INCREASED TO PREVENT THE TYPE OF DISASTROUS AND TRAGIC FAMINE CONDITIONS THAT WE WITNESSED OVER THE PAST TWO YEARS.

AID CONTINUES TO SUPPORT OPERATIONAL RESEARCH TO TEST ALTERNATIVE MEANS OF DELIVERING PROVEN, EFFECTIVE CHILD SURVIVAL INTERVENTIONS SUCH AS ORT, IMMUNIZATION, CHILD SPACING AND BREASTFEEDING PROMOTION. WE HAVE DOCUMENTED DRAMATIC CHANGES IN HEALTH PRACTICES AND OUTCOMES AS A RESULT OF EFFECTIVE APPLICATION OF FAMILIAR ADVERTISING TECHNIQUES AND OTHER MODERN COMMUNICATION PRACTICES.

FINALLY, WE ARE PROVIDING STRONG SUPPORT TO INSTITUTIONAL DEVELOPMENT. IN ONE SENSE THIS IS NOT NEW, BECAUSE DEVELOPMENT OF INSTITUTIONS HAS BEEN A KEY PART OF THE AID PROGRAM SINCE ITS BEGINNING. AMERICAN UNIVERSITIES HAVE PLAYED A CRITICAL ROLE AS HAVE THE PRIVATE VOLUNTARY ORGANIZATIONS. WE HAVE MANY EXAMPLES OF INSTITUTIONS DEVELOPED BY AMERICAN ASSISTANCE

THROUGH THE JOINT EFFORTS OF HOST COUNTRIES AND AMERICAN COUNTERPARTS, AS FOR EXAMPLE, THE INDIAN INSTITUTES OF TECHNOLOGY. IN RECENT YEARS WE CAN POINT TO THE DEVELOPMENT OF MORE EFFECTIVE NATIONAL AGRICULTURE RESEARCH EFFORTS IN SUCH AFRICAN COUNTRIES AS CAMEROON, KENYA, AND MALAWI.

WE CAN POINT TO MANY OTHER CASES OF SUCCESSFUL INSTITUTIONAL DEVELOPMENT EFFORTS IN WHICH WE HAVE PLAYED A KEY ROLE. FOR EXAMPLE, IN EL SALVADOR, WE HAVE SUPPORTED FUSADES -- A NON-PROFIT DEVELOPMENT ORGANIZATION, PROVIDING NON-PARTISAN SOLUTIONS TO EL SALVADOR'S ECONOMIC AND SOCIAL PROBLEMS. FUSADES HAS BEEN INSTRUMENTAL IN SUPPORTING TRADE AND INVESTMENT PROMOTION THROUGH A TRADE AND INVESTMENT PROMOTION SERVICE THAT PROMOTES PRIVATE INVESTMENT IN PRODUCTION OF NON-TRADITIONAL EXPORTS, SUPPLYING TECHNICAL ASSISTANCE AND MARKET ACCESS INFORMATION; AN AGRICULTURAL DIVERSIFICATION PROGRAM; A PROGRAM AIMED AT ENHANCING PRIVATE SECTOR ORGANIZATIONS' EFFECTIVENESS; AND SMALL BUSINESS DEVELOPMENT PROGRAM SUPPLYING CREDIT, TRAINING AND TECHNICAL ASSISTANCE.

ALONG WITH THESE BASIC MEANS, OR PILLARS, OF ASSISTANCE WHICH THIS ADMINISTRATION HAS EMPHASIZED, WE HAVE STRIVED FOR MORE EFFECTIVE ADMINISTRATION OF THE PROGRAM THROUGH:

- GREATER DECENTRALIZATION TO THE FIELD COUPLED WITH MORE EFFECTIVE MANAGEMENT OVERSIGHT PROCEDURES TO MONITOR PERFORMANCE. THE DEPUTY ADMINISTRATOR HAS BEEN CHARGED WITH AN

EFFORT TO BRING ABOUT MUCH GREATER DELEGATION OF AUTHORITY TO THE FIELD MISSIONS. THIS PROCESS IS CONTINUING.

- TRIMMING DOWN OF MISSIONS WHERE POSSIBLE AND IN SOME CASES TRANSFORMING PROGRAMS FROM COMPREHENSIVE APPROACHES TO A SINGLE FOCUS, SUCH AS PARTICIPANT TRAINING, WHICH MAKES FOR GREATER EASE IN ADMINISTRATION.
- STREAMLINING OF THE AGENCY'S PLANNING PROCESS.

THESE ARE SOME OF THE MEANS BY WHICH WE HAVE ATTEMPTED TO BRING ABOUT FUNDAMENTAL CHANGES IN OUR AID PROGRAM, AND I THINK WE HAVE HAD A CONSIDERABLE MEASURE OF SUCCESS.

THE NEED FOR THIS PROPOSED FY 1987 ECONOMIC ASSISTANCE PROGRAM IS EVIDENT -- BOTH IN TERMS OF BASIC ELEMENTS OF SELF-INTEREST AND U.S FOREIGN POLICY OBJECTIVES AND ALSO IN TERMS OF THE CONDITIONS OF POVERTY AND THE NEED FOR CHANGE IN SO MANY COUNTRIES. THE WORLD BANK HAS ESTIMATED THAT THERE ARE 1 BILLION PEOPLE LIVING IN ABSOLUTE POVERTY, "A CONDITION OF LIFE SO CHARACTERIZED BY MALNUTRITION, ILLITERACY AND DISEASE TO BE BENEATH ANY REASONABLE DEFINITION OF HUMAN DECENCY." THAT IS FUNDAMENTALLY AT THE CORE OF WHAT THIS COUNTRY IS ATTEMPTING TO ATTACK THROUGH OUR ECONOMIC ASSISTANCE EFFORTS.

SOME OF THE KEY FUNCTIONAL AREAS THAT WE HAVE EMPHASIZED ARE THOSE THAT THIS COMMITTEE HAS GIVEN PARTICULAR ATTENTION TO.

ONE IS HEALTH AND CHILD SURVIVAL, WHICH IS A VERY HIGH PRIORITY WITHIN THIS AGENCY. IN FY 1986 WE RECEIVED $50 MILLION FROM THE CONGRESS, AND WE HAVE MADE A TENTATIVE

ALLOCATION OF THOSE FUNDS TO VARIOUS COUNTRIES AND CENTRAL PROGRAMS. MANY OF OUR PREVIOUSLY INITIATED HEALTH PROGRAMS ALSO INCLUDE CHILD SURVIVAL COMPONENTS AND WE EXPECT THAT THERE WILL BE CONSIDERABLY MORE FUNDING FOR CHILD SURVIVAL ACTIVITIES IN FY 1987. WE HAVE A SPECIFIC REQUEST FOR $25 MILLION IN THE BUDGET, BUT THAT WILL ONLY BE A PORTION OF OUR TOTAL RESPONSE. CHILD SURVIVAL ACTIVITIES WILL BE FUNDED FROM THE HEALTH, CHILD SURVIVAL, AND SAHEL ACCOUNTS, AND FROM PL 480 LOCAL CURRENCY AND ESF FUNDS.

ORT AND IMMUNIZATION ARE THE TWO THE MOST IMPORTANT INTERVENTIONS FOR CHILD SURVIVAL. THEY ARE THE TWIN ENGINES THAT CAN SAVE LIVES AND HELP BUILD A DELIVERY SYSTEM FOR OTHER HEALTH EFFORTS. A GREAT DEAL HAS BEEN SAID ABOUT IMMUNIZATION LATELY AND APPROPRIATELY SO. HOWEVER, WE SHOULD KEEP IN MIND THAT ORT CAN SAVE AS MANY IF NOT MORE LIVES. THESE "TWIN ENGINES" AS JIM GRANT AND I HAVE BEEN CALLING THEM SHOULD INDEED GO TOGETHER. AT THE ICORT CONFERENCE IN DECEMBER, I PROPOSED THAT BY 1990 TWO MILLION CHILDREN COULD BE SAVED FROM DEATH FROM DEHYDRATION BY THE USE OF ORT. AID IS ALSO PLEDGED TO COLLABORATE IN AN INTERNATIONAL EFFORT TO PROVIDE IMMUNIZATIONS FOR ALL THE WORLD'S CHILDREN, WITH SPECIFIC COVERAGE GOALS TO BE DEFINED AT THE COUNTRY LEVELS. THE DIMENSIONS OF THE TASK ARE MONUMENTAL -- 15 MILLION CHILDREN DIE EACH YEAR IN A.I.D. ASSISTED COUNTRIES AND ABOUT HALF OF THESE DEATHS ARE PREVENTABLE THROUGH ORT AND IMMUNIZATION.

THROUGH CAREFUL COORDINATION AMONG DONORS TO CONSERVE AVAILABLE RESOURCES FOR CHILD SURVIVAL, AND THROUGH EFFECTIVE PROGRAMMING OF THESE FUNDS, WE EXPECT TO BE ABLE TO ACHIEVE THESE AMBITIOUS GOALS. WE ARE CURRENTLY DEVELOPING A LONG-TERM CHILD SURVIVAL STRATEGY FOR THE AGENCY TO GUIDE ALLOCATION AND PROGRAMMING DECISIONS IN THIS AREA.

ANOTHER VERY IMPORTANT PRIORITY IS THE AREA OF AGRICULTURE. INCREASED FOOD PRODUCTION CONTINUES TO BE A CRITICAL PRIORITY. IT IS ESSENTIAL TO CONTINUE AGRICULTURE RESEARCH. IT IS IMPORTANT TO CARRY OUT POLICY CHANGES AND TO PROVIDE TECHNICAL ASSISTANCE IN AGRICULTURE WHICH WILL BRING ABOUT FUNDAMENTAL CHANGE. THE NEEDS IN AFRICA FOR INCREASED FOOD PRODUCTION ARE PARAMOUNT, BUT AGRICULTURAL PRODUCTIVITY AND DISTRIBUTION MUST BE IMPROVED THROUGHOUT MOST OF THE DEVELOPING WORLD IN ORDER TO IMPROVE NUTRITION AND ENSURE THE AVAILABILITY OF ESSENTIAL FOODS FOR A STILL RAPIDLY GROWING POPULATION. WE HAVE INCLUDED IN OUR BUDGET ADDITIONAL FUNDS IN AGRICULTURE BEYOND WHAT WE RECEIVED IN FY 1986. AFRICA WILL RECEIVE APPROXIMATELY 20 PERCENT OF THE PROPOSED FY 1987 AGRICULTURE BUDGET REQUEST.

WE PLAN TO CONTINUE TO EMPHASIZE TECHNICAL ASSISTANCE IN AGRICULTURE, ONE OF OUR AREAS OF COMPARATIVE ADVANTAGE IN DEVELOPMENT ASSISTANCE WHERE WE HAVE HAD PARTICULAR SUCCESS IN THE PAST. FOR EXAMPLE, AS A RESULT OF OUR ASSISTANCE, THE NATIONAL CEREALS RESEARCH AND EXTENSION PROJECT IN CAMEROON IS

DEVELOPING AN INSTITUTIONAL CAPACITY THAT WILL PROVIDE HIGH-QUALITY RESEARCH ON MAIZE, RICE, SORGHUM AND MILLET FOR USE BY SMALL FARMERS. ANOTHER EXAMPLE IS THE REGIONAL STRENGTHENING AFRICAN AGRICULTURAL RESEARCH PROJECT, THROUGH WHICH WE ARE PARTICIPATING WITH OTHER DONOR NATIONS IN MAJOR INITIATIVES TO REORIENT AND STRENGTHEN NATIONAL AND REGIONAL RESEARCH INSTITUTIONS WHICH HAVE THE POTENTIAL TO HELP INCREASE SMALLHOLDER PRODUCTIVITY. THIS LONG-TERM PROGRAM, IN COLLABORATION WITH INTERNATIONAL AGRICULTURAL RESEARCH CENTERS, IS SUPPORTING FARMING SYSTEMS RESEARCH, STRENGTHENING RESEARCH LINKAGES TO EXTENSION, PROVIDING TECHNICAL AND ADMINISTRATIVE TRAINING, AND HELPING ESTABLISH REGIONAL NETWORKS OF SCIENTISTS TO SPREAD RESEARCH RESULTS AMONG SUB-SAHARAN AFRICAN COUNTRIES.

FAMILY PLANNING IS ALSO AN AREA OF HIGH PRIORITY AREA IN OUR ASSISTANCE PROGRAM. SUPPORT FOR VOLUNTARY FAMILY PLANNING EFFORTS CONTINUES TO RECEIVE CONSIDERABLE ATTENTION IN AID. THE DEMAND FOR FAMILY PLANNING SERVICES HAS INCREASED AS MODERNIZATION HAS MADE SMALLER FAMILIES MORE DESIRABLE FOR A GREAT MANY COUPLES IN MOST DEVELOPING COUNTRIES. AN INCREASING NUMBER OF COUNTRIES HAVE BECOME CONCERNED ABOUT THEIR ABILITY TO FEED, EDUCATE AND PRODUCTIVELY EMPLOY GROWING NUMBERS OF PEOPLE AS A RESULT OF HIGH POPULATION GROWTH RATES, IN SOME AREAS AS HIGH AS 4 PERCENT. THE RATIONALE OF AID POPULATION ASSISTANCE IS NOT TO REDUCE POPULATION GROWTH RATES PER SE, BUT BECAUSE FAMILY PLANNING SERVICES ALLOW CHOICES WHICH DIRECTLY BENEFIT INDIVIDUAL FAMILIES IN A NUMBER OF WAYS.

ONE IMPORTANT REASON FOR OUR CONTINUED COMMITMENT TO FAMILY PLANNING IS THAT IT ALLOWS COUPLES TO ACHIEVE THEIR OWN FAMILY DECISIONS ABOUT THE NUMBER AND SPACING OF THEIR CHILDREN. FEWER CHILDREN ARE AN OPTION WHICH AMERICAN FAMILIES TAKE FOR GRANTED. IT IS NOT AN OPTION FOR MILLIONS OF FAMILIES IN THE THIRD WORLD WHERE FAMILY PLANNING SERVICES ARE NOT AVAILABLE. TODAY IMPROVEMENTS IN HEALTH SERVICES, URBAN LIFE STYLES, AND BETTER EDUCATED MOTHERS, MEAN THAT FAMILIES EVERYWHERE WANT FEWER CHILDREN. THESE FAMILIES DESERVE THE FREEDOM TO ACHIEVE THEIR OWN FAMILY DECISIONS.

MATERNAL AND CHILD HEALTH IS A SECOND IMPORTANT REASON FOR FAMILY PLANNING. A CHILD BORN WITHIN TWO YEARS OF AN EARLIER BIRTH IS TWICE AS LIKELY TO DIE AS A CHILD BORN AFTER AN INTERVAL OF TWO OR MORE YEARS. FAMILY PLANNING SAVES LIVES AND IS ONE OF THE FOUR PRIMARY INTERVENTIONS IN THE AGENCY'S CHILD SURVIVAL STRATEGY.

THE ADMINISTRATION IS STRONGLY OPPOSED TO THE PRACTICE OF ABORTION AS A METHOD OF FAMILY PLANNING AND AID HAS TAKEN STEPS TO ENFORCE THE POLICY OF DISSOCIATION OF U.S. FUNDS FROM ABORTION-RELATED ACTIVITIES. I BELIEVE THAT WE MUST NOT ONLY OPPOSE ABORTION BUT ALSO PROVIDE THE MEANS BY WHICH TO REDUCE THE INCIDENCE OF ABORTION. WE KNOW THAT FAMILY PLANNING IS AN ALTERNATIVE TO ABORTION AND AS SUCH IT IS IMPORTANT TO INCREASE ITS ACCESSIBILITY THROUGHOUT THE DEVELOPING WORLD AS A MEANS OF PREVENTING ABORTION.

- Details of FY 1987 request.

Our request for the Functional Development Assistance accounts, including the Sahel, is $1.627 billion. It compares to $1.554 billion appropriated in FY 1986 after sequestration. The request, in total, is below the $1.754 billion authorized by this Committee.

- In Agriculture we are requesting $709 million, less than the authorization level of $760 million, but an increase from the considerably reduced appropriation of $670 million in FY 1986. Agriculture remains a key element of AID's development efforts worldwide, and any major reduction seriously affects our ability to maintain effective agriculture research efforts and to provide policy and technical assistance to a host of countries where food production increases are mandatory.
- For Population we are requesting $250 million, the amount authorized and a straightline of FY 1986 levels pre-sequestration. The request reflects our continued commitment to the provision of voluntary family planning services.
- In Health we are requesting $151 million, compared to an authorized level of $205 million. In addition, as part of the general health effort, we are specifically requesting $25 million for Child Survival. The combined health and Child Survival request represents an increase of $30 million from the FY 1986 request, reflecting the priority we have accorded to

THIS AREA. AT THE SAME TIME, THE AID BUDGET IS CLEARLY GOING TO GET ONLY SO MUCH MONEY AND OTHER ACCOUNTS, PERHAPS LESS EMOTIONALLY APPEALING THAN HEALTH, MUST BE ADDRESSED FOR REAL IMPROVEMENT OF LIVES. FOR EXAMPLE, WE MUST PROVIDE MONEY TO AGRICULTURE IN ORDER TO PRODUCE FOOD, THE ONLY PERMANENT MEANS TO ACHIEVE HEALTH.

- OUR REQUEST FOR EDUCATION AND HUMAN RESOURCES IS $179 MILLION, WHICH IS WITHIN THE AUTHORIZED LEVEL OF $180 MILLION, TO MAINTAIN OUR EMPHASIS ON EDUCATION AND TRAINING. AS PART OF THAT CONTINUING EMPHASIS, I AM PLEASED TO BE ABLE TO REPORT THAT WE ARE MAKING EXCELLENT STRIDES IN PARTICIPANT TRAINING -- WHICH IS FUNDED OUT OF SEVERAL OF THE FUNCTIONAL ACCOUNTS. WE BEGAN GIVING GREATER EMPHASIS TO PARTICIPANT TRAINING IN 1982. SINCE THEN THE NUMBER OF AID PARTICIPANTS IN TRAINING IN THIS COUNTRY HAS GROWN DRAMATICALLY. IN FY 1982, WE TRAINED ABOUT 8,000 PARTICIPANTS. BY FY 1985 THE NUMBER HAD RISEN TO MORE THAN 12,500 -- A 56 PERCENT INCREASE -- AND I EXPECT THAT TREND TO CONTINUE. I HAVE A HANDOUT, WHICH I WILL PROVIDE FOR THE RECORD, WHICH SHOWS THIS TREND OVER THE PAST SEVERAL YEARS IN THE NUMBER OF PARTICIPANTS, THEIR GEOGRAPHIC ORIGIN AND THE MAJOR SUBJECT AREAS IN WHICH TRAINING HAS BEEN PROVIDED.

- SELECTED DEVELOPMENT ACTIVITIES, AT $231 MILLION INCLUDING $14 MILLION FOR THE OFFICE OF THE SCIENCE ADVISOR, IS THE ONE AREA IN THE FUNCTIONAL ACCOUNTS WHERE OUR REQUEST EXCEEDS THE

AUTHORIZED LEVEL ($207 MILLION) BECAUSE OF OUR INCREASING RELIANCE UPON DEVELOPMENT OF MARKET FORCE INSTITUTIONS. THE REDUCTION TO $166 MILLION IN FY 1986 HAS SHARPLY CURTAILED MANY PRIVATE SECTOR EMPHASES WITHIN THE AGENCY. FURTHERMORE, SINCE ROUGHLY HALF OF THE SDA ACCOUNT IS SPENT IN LATIN AMERICA AND THE CARIBBEAN, THE 1986 REDUCTION MEANT WE HAD TO SUBSTANTIALLY ALTER OUR EMPHASES IN THESE REGIONS. YET THE SPECIFIC NEEDS IN CENTRAL AMERICA MEAN THAT THE AVAILABILITY OF FUNDS FOR SELECTED DEVELOPMENT ACTIVITIES IS ESPECIALLY IMPORTANT.

- FOR THE SAHEL DEVELOPMENT PROGRAM, WE ARE REQUESTING $80 MILLION, ESSENTIALLY THE SAME AS THE FY 1986 APPROPRIATION. WE ARE PROPOSING THAT THIS PROGRAM BE FUNDED UNDER THE FUNCTIONAL DEVELOPMENT ASSISTANCE PROGRAM.
- WE HAVE REQUESTED $10 MILLION FOR THE AMERICAN SCHOOLS AND HOSPITALS PROGRAM, THE SAME AS OUR FY 1986 REQUEST.
- WE HAVE REQUESTED $10 MILLION TO REPLENISH THE HOUSING GUARANTY RESERVES, DEPLETED AS A RESULT OF INCREASED RESCHEDULING OF OUTSTANDING LOANS. THE ADMINISTRATION PROPOSES TO TERMINATE THE HOUSING GUARANTY PROGRAM IN FY 1987 BECAUSE MARKET RATE LOANS WITH AN AID GUARANTEE HAVE NOT PROVEN TO BE APPROPRIATE FOR ALL POOR COUNTRIES AND BECAUSE HOUSING GUARANTIES ARE NOT CONSISTENT WITH FEDERAL CREDIT POLICY.
- OUR REQUEST ALSO INCLUDES $389 MILLION IN AID OPERATING EXPENSES, PLUS $21 MILLION FOR THE INSPECTOR GENERAL. THE AID REQUEST IS THE MINIMUM AMOUNT NECESSARY TO ADEQUATELY MANAGE

THE AGENCY'S PLANNED PROGRAM FOR FY 1987. THIS LEVEL WILL PROVIDE FOR AN AID STAFFING LEVEL OF 4,825 -- WHICH WILL REPRESENT A REDUCTION OF 1,000 POSITIONS DURING THE SIX YEARS SINCE I TOOK OFFICE IN 1981. IN ADDITION TO REDUCING STAFF AND CAREFULLY MANAGING THE USE OF OUR REMAINING PERSONNEL, WE HAVE INTRODUCED A NUMBER OF OTHER MANAGEMENT IMPROVEMENTS TO CUT COSTS AND INCREASE EFFICIENCY. THESE INCLUDE GREATER USE OF AUTOMATION, INTRODUCTION OF A STANDARDIZED OVERSEAS ACCOUNTING SYSTEM, IMPROVED WORK SPACE MANAGEMENT, BETTER TRAINING FOR PROJECT IMPLEMENTERS, BETTER CASH MANAGEMENT, AND INTRODUCTION OF PRODUCTIVITY REVIEW STUDIES.

- FOR THE ECONOMIC SUPPORT FUND, WE ARE REQUESTING JUST OVER $4 BILLION -- ESSENTIALLY THE SAME AS OUR REQUEST LAST YEAR. THE FY 1986 ESF APPROPRIATION WAS REDUCED AFTER SEQUESTRATION TO $3.5 BILLION, OF WHICH $2.3 BILLION WAS EARMARKED. AS A RESULT, WE HAD TO CUT BACK CONSIDERABLY IN MANY COUNTRIES IN CENTRAL AMERICA AND IN AFRICA. OUR REQUEST THIS YEAR HELPS TO REGAIN SOME OF THE LOST MOMENTUM.

FROM A GEOGRAPHIC STANDPOINT, THE ALLOCATION OF DA AND ESF REPRESENTS SOME SHIFTS AMONG COUNTRIES AND REGIONS COMPARED TO THE AMOUNTS WE CURRENTLY HAVE BUDGETED FOR FY 1986.

-- IN AFRICA, THE REQUEST FOR DA AND ESF TOTALS $750 MILLION, UP A TOTAL OF $125 MILLION OVER CURRENT FY 1986 LEVELS, PRINCIPALLY IN ESF. THE INCREASE IS DISTRIBUTED AMONG SEVERAL COUNTRIES INCLUDING SOMALIA, SUDAN, LIBERIA, AND

Kenya. The request also includes funding for the third year of the African Economic Policy Reform Program at a level of $75 million, the same as the request for the prior two years, although it is an increase over the amount we allocated in FY 1986 following reductions in the ESF appropriation.

-- For the Asia and Near East region, we are requesting a total of $3.1 billion in DA and ESF, compared to the $4.1 billion we expect to obligate in FY 1986. DA levels are essentially the same as in FY 1986, at about a two percent decrease, and shifts in country levels are mostly nominal. The ESF request represents less than a one percent increase over the FY 1986 request levels and is about $1 billion less than ESF obligations in FY 1986 -- which includes funds from the FY 1985 Middle East supplemental. The ESF request contains increases over FY 1986 levels for Jordan, Morocco, Oman, Turkey and the Regional program but these increases in almost all cases would only return ESF assistance to about pre-FY 1986 levels. ESF allocations for Israel and Egypt reflect no change from the FY 1986 earmarks of $1.2 billion and $815 million respectively. $15 million is requested for humanitarian assistance to the Afghan Freedom Fighters. This mirrors the FY 1986 earmark.

-- In Latin America, the total DA and ESF request is $1.4 billion, compared to $1.1 billion in FY 1986. The increase is primarily due to increased ESF funding principally for Central America but also for South America and the Caribbean countries. We must underscore the priority we are attributing to the Central America Initiative this year in view of the overwhelming progress toward democratization in the region and the tremendous need for acceleration of economic recovery in order to sustain those young democracies and stabilize their economies. This assistance is even more crucial since armed stuggle in the region continues.

The requested levels come close to those which were recommended by the National Bipartisan Commission on Central America; however, we have fallen far short of those recommendations in prior years and unless we begin to devote the level of resources which we are proposing to the economic and social problems there, we have little hope of achieving our objectives.

In the case of South America, we are supplying ESF funds for balance of payments support in Ecuador, Bolivia, Peru and Uruguay. New, democratically-elected governments have instituted significant economic policy reforms in Ecuador, Bolivia and Uruguay, and U.S. Government support is essential if these countries are to be able to import the

NECESSARY INPUTS FOR INCREASED PRODUCTION AND STIMULATION OF PRIVATE SECTOR GROWTH.

INCREASES IN FUNDING FOR LATIN AMERICA ALSO ARE IMPORTANT IF WE ARE TO CONTINUE ASSISTING GOVERNMENTS TO MOVE TOWARD IMPLEMENTING ENLIGHTENED POLICIES ON NARCOTICS CONTROL WHICH IS A MAJOR U.S. CONCERN. IN ADDITION, ADMINISTRATION OF JUSTICE AND JUDICIAL REFORM EFFORTS ARE NEW AREAS IN WHICH WE MUST DO EVERYTHING POSSIBLE SO THAT THE DEMOCRATIZATION PROCESS WILL NOT FALTER.

ANOTHER KEY ELEMENT OF OUR PROGRAM IN LATIN AMERICA IS OUR SUPPORT FOR NARCOTICS EDUCATION PROGRAMS. A CRITICAL ELEMENT OF THE ADMINISTRATION'S STRATEGY FOR DEALING WITH THE INTERNATIONAL NARCOTICS PROBLEM IS TO MAKE GOVERNMENTS, OPINION LEADERS AND THE GENERAL PUBLIC OF KEY PRODUCING AND TRANSITING COUNTRIES BETTER INFORMED AS TO THE HAZARDS THAT NARCOTICS PRODUCTION AND TRAFFICKING POSE TO THEIR OWN SOCIETIES. AID PLANS TO COMMIT A TOTAL OF $5 MILLION IN DA FUNDS TO SUCH NARCOTICS AWARENESS ACTIVITIES IN FIVE LATIN AMERICAN COUNTRIES -- BOLIVIA, ECUADOR, PERU, BELIZE AND JAMAICA. OUR ASSISTANCE WILL SERVE TO COMPLEMENT OR EXPAND NARCOTICS AWARENESS AND EDUCATION INITIATIVES BEING FUNDED BY THE US INFORMATION AGENCY AND THE STATE DEPARTMENT'S INTERNATIONAL NARCOTICS PROGRAMS AND WILL SUPPORT ACTIVITIES OF BOTH PRIVATE AND PUBLIC INDIGENOUS INSTITUTIONS CONCERNED WITH NARCOTICS ABUSE.

-- Centrally funded DA programs total $467 million, a $4.3 million reduction from the FY 1986 level. These funds support a wide variety of activities with a world-wide focus, including basic and applied research, development and testing of appropriate technology, private enterprise activities, grants to private voluntary organizations, support for International Agricultural Research Centers, Women in Development activities, and support for cooperative activities with the Peace Corps. These programs are funded centrally because of their global focus and because of efficiencies possible from consolidated central management. The programs do have an impact on those living in the developing countries. As our Congressional Presentation reflects for the first time, $183 million of these funds are directly attributable to programs in recipient countries. The centrally funded portion of our request also includes $25 million for the International Disaster Assistance program in which we are actively participating with dozens of developing countries in mitigating the effects of disasters which tragically took so many lives through famine, earthquakes and cyclones last year.

- For PL 480, the total budget authority request is $1.164 billion. The Title I request of $564 million in budget authority will support a program level of $944 million, sufficient to provide 5.3 million metric tons to 31 countries.

For Title II, we are requesting $600 million, which we project will enable us to provide just over 1.9 million metric tons (grain equivalent) of food. We intend to continue the expansion of PVO programs in Africa that began in FY 1986 to assist the recovery from the effects of the Africa drought. Portions of some PVO programs will be monetized in order to provide necessary resources for successful program implementation.

- For the Trade and Development Program, we are requesting $18 million, essentially the same as the FY 1986 level after sequestration.
- Under Multilateral Assistance, the Administration is requesting a total of $1.39 billion for existing commitments to the Multilateral Development Banks and for funding of the new Multilateral Investment Guaranty Agency. This new organization can have a very useful impact on developing country policies toward foreign investment and on encouraging increases in investment.
- For International Organizations and Programs, we are requesting $186 million.
- The Administration is also requesting $126 million for the Peace Corps. May I note that over the past few years the extent of cooperation between AID and the Peace Corps has increased greatly, leading to a much better joint effort by the

TWO AGENCIES IN CARRYING OUT AMERICAN FOREIGN POLICY OBJECTIVES AND IN HELPING TO MEET BASIC DEVELOPMENT NEEDS.

AID'S ULTIMATE GOAL IS A WORLD IN WHICH ECONOMIC GROWTH AND DEVELOPMENT ARE SELF-SUSTAINING AND EXTREMES OF POVERTY HAVE BEEN ELIMINATED. THE LONG-RANGE FOREIGN POLICY OBJECTIVES OF THE UNITED STATES ARE BEST SERVED BY A WORLD OF SUSTAINED ECONOMIC DEVELOPMENT AND GENERAL HUMAN WELL-BEING. OUR TASK IS TO HELP POOR PEOPLE TO HELP THEMSELVES THROUGH ENHANCED OPPORTUNITY. THIS IS A GOVERNING PHILOSOPHY OF THE ASSISTANCE PROGRAM THAT WE ARE SUBMITTING TO YOU. WE BELIEVE THIS PROGRAM WORTHY OF YOUR CONTINUED STRONG SUPPORT.

MR. CHAIRMAN, I WILL BE PLEASED TO ANSWER YOUR QUESTIONS.

* * *

## SUMMARY OF PARTICIPANT TRAINING TRENDS (U.S. Training Only), FY 1978-85

| Subject Areas and Regions | 1978 | 1979 | 1980 | 1981 | 1982 | 1983 | 1984 | 1985 |
|---|---|---|---|---|---|---|---|---|
| Total Number of Participants..... | 6,005 | 5,905 | 8,008 | 7,844 | 7,885 | 9,012 | 11,410 | 12,54 |
| Percent Distribution of Participants by Region (total)............. | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 |
| Africa......................... | 36 | 40 | 40 | 39 | 38 | 37 | 32 | 26 |
| Near East...................... | 17 | 21 | 23 | 30 | 32 | 32 | 34 | 30 |
| Asia........................... | 21 | 16 | 20 | 16 | 17 | 16 | 15 | 15 |
| Latin America & Caribbean. ..... | 26 | 23 | 17 | 15 | 13 | 15 | 19 | 29 |
| Percent Distribution of Participants by Subject Areas (total)....... | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 |
| Agriculture.................... | 21 | 26 | 28 | 31 | 31 | 31 | 29 | 28 |
| Industry....................... | 5 | 7 | 8 | 12 | 15 | 20 | 20 | 22 |
| Transportation................. | 1 | 1 | 2 | 2 | 1 | 1 | 1 | 1 |
| Labor.......................... | 8 | 7 | 6 | 6 | 7 | 5 | 5 | 4 |
| Health/Family Planning......... | 19 | 19 | 19 | 17 | 17 | 16 | 16 | 15 |
| Education...................... | 26 | 22 | 16 | 12 | 9 | 7 | 7 | 6 |
| Public Administration.......... | 16 | 12 | 15 | 15 | 14 | 14 | 16 | 18 |
| Housing/Community Development.. | 1 | 2 | 3 | 3 | 4 | 4 | 3 | 3 |
| Miscellaneous.................. | 3 | 4 | 3 | 2 | 2 | 2 | 3 | 3 |

### IMPACT ON THIRD WORLD FROM DROP IN OIL PRICES

Mr. OBEY. Peter, in this country we originally projected a growth rate, mostly private forecasts—projected an economic growth rate this year of around 2.5 percent, 3 percent.

Last year we had a growth rate of 2.3 percent. We have a tremendous drop in oil prices, as you know, and it is continuing, and that has meant that private economic forecasters are now suggesting that while they disagreed with the Administration's basic economic growth numbers or projections for the coming year, they feel now with the drop in oil prices we had a fair chance of hitting, say, 4 percent growth this year, which would be a much larger increase in growth than we have averaged in the last five years.

That has tremendous consequences for our economy. The same is true for the Third World countries. This budget was prepared really before we experienced the dramatic drop in oil prices.

My question to you is, have you—has the Administration, generally, to your knowledge, taken a look at what the drop in oil prices is doing to increase the economic strength of a lot of the countries we are dealing with in this bill?

Have you taken a look at the impact it has on the downside for some of the countries in this bill who are oil producers?

And as a result of that, could this committee expect to come up with a revised set of listings in terms of who is going to get what, because we have seen a really fundamental change which is going to make it a whale of a lot tougher or a number of small countries and a lot easier for a lot of other countries to get by.

Mr. MCPHERSON. We think both exports and imports need to be taken into consideration. In formulating the 1986 budget, the process we just went through a few weeks ago, we had a lot of discussion about the prices of commodities from coffee to cotton. It was at that time that we lerned that the price of oil was dropping.

Careful analysis has been undertaken concerning the negative impact on countries as a result of the drop of petroleum prices.

Yesterday, there was mention of how Ecuador, when petroleum went below $20, was going to be severely affected.

We have done some analysis, but the figures aren't easy to get for some other countries who, like Jamaica, import practically every drop of petroleum which is consumed in that country.

We think that 1985 was such a bad year for so many countries that the drop in petroleum prices will only make things a little better for many. It will make the world easier, but in no way will it fundamentally cure the kind of needs——

### IMPACT ON THE 42 POOREST COUNTRIES FROM THE DROP IN OIL PRICES

Mr. OBEY. Here is what I am trying to get at. If you take a look at many of these countries—our budget, for instance, the budget you are submitting to us this year; let me put it in perspective.

This overall bill, economic and military, has grown by 143 percent over the last five years. And yet, if you take a look at direct development assistance to the poorest 42 countries in the world, that amounted to $442 million in 1981. It amounted to $448 million in the budget that you are submitting this year, a very tiny increase.

That means that the impact of our aid in some of those countries is very, very small as a percentage of their economies, simply because this aid is so small.

I would expect that the impact on those same economies from oil prices would be much, much larger than any change in this aid program, up or down.

So, I guess what I would like you to do is, if you would, take a reasonable sample of the 42 poorest countries, say, take ten of them. If you could, get back to us with some idea of what that oil price drop is going to do to change their economies.

I mean, quantify it, not in general terms.

Mr. McPHERSON. We will tell you, for example, what it means to Bangladesh to have a drop in oil prices using $25 as a base.

### IMPACT ON HIGHER INCOME COUNTRIES FROM OIL PRICE DROP

Mr. OBEY. The second question—and I also would like you to do that, then, for a selected list of countries much higher up on the income scale.

Mr. McPHERSON. We would be very happy to do that.

As I say, indeed, we worry quite a bit about this. We see it as a positive trend. It is important, I think, to also look at economic growth rates, such as the ones we had in Central America last year.

In fact, I know you have those figures. You will see that in 1984 we had, in some countries in Central America, higher growth rates than we had in 1985. We believe that, in fact, the drop in petroleum prices will help us reverse that trend.

Mr. OBEY. Just give us the numbers.

[The information follows:]

## Effects on 20 Developing Nations of an $11.50 Drop in Oil Prices

Table 1 estimates the net effect of an $11.50 drop in oil prices on the foreign exchange expenses of 10 low income countries and of six lower middle income countries that are net importers of petroleum and petroleum products. Table 1 also estimates the net effect of the drop in oil prices on the foreign exchange revenues of four lower middle-income oil exporters. The net effect on each country is compared with that country's estimated 1986 U.S. bilateral economic assistance and with its net 1984 official development assistance (ODA) receipts from all sources. To provide perspective on the size of each country's estimated net losses or gains, Table 1 shows the estimated net annual gain or loss as a percent of each country's 1983 gross national product (GNP) and as a percent of its 1984 merchandise imports.

For each country, the net figure sums five effects of a drop in oil price from $26.50 to $15 per barrel:

-- narrowly, on each country's net trade in petroleum, the annual dollar savings for oil importers, the annual dollar losses of oil exporters assuming country oil trade at the 1985 level,

-- the dollar value of savings on interest rate costs on foreign private debt assuming an interest rate lower than otherwise by 2.25 points,

-- the dollar value of increased merchandise exports assuming the Organization for Economic Development and Cooperation (OECD) countries' growth rate is 1.5 percentage points larger than otherwise,

-- the dollar value of decline in the remittances from native workers employed in the Persian Gulf countries, assuming reductions ranging from 1% for Morocco to 15% for Sudan, Indonesia, Bangladesh, and Pakistan.

-- the dollar value of a reduction of one-third in net official development assistance from members of OPEC.

Table 2 and its footnotes give the detailed assumptions on which the computations were based. Table 2 also presents the detailed

Table 1: For 20 Developing Countries, Net Annual Gains or Losses from a Fall to $15.00 Oil: Dollar Totals and as a Percent of 1983 GNP and of 1984 Merchandise Imports; Also Comparison with Estimated U.S. 1986 Bilateral Economic Assistance and with Net Official Development Assistance.

| 10 Low Income Oil Importers | Net Annual Gains ($mil) | Estimated U.S. Economic Asst.1986 ($mil) | Net Official Development Asst.1984 ($mil) | Net Annual Gains as a Percentage of | |
|---|---|---|---|---|---|
| | | | | GNP 1983 | Imports 1984 |
| Bangladesh | $79 | $162 | $675 | 0.6% | 2.8% |
| Haiti | 28 | 50 | 71 | 1.7% | 4.0% |
| India | 667 | 155 | 1,547 | 0.3% | 3.8% |
| Kenya | 114 | 48 | 431 | 1.8% | 6.8% |
| Malawi | 9 | 9 | 159 | 0.7% | 6.0% |
| Nepal | 14 | 14 | 198 | 0.6% | 5.6% |
| Pakistan | 186 | 313 | 698 | 0.5% | 3.2% |
| Sri Lanka | 144 | 49 | 468 | 2.8% | 7.8% |
| Sudan | 10 | 134 | 616 | 0.1% | 0.7% |
| 6 Middle Income Oil Importers | | | | | |
| Zimbabwe | 48 | 21 | 298 | 0.8% | 6.3% |
| Honduras | 73 | 123 | 290 | 2.7% | 8.8% |
| Morocco | 444 | 77 | 285 | 2.8% | 10.9% |
| Philippines | 825 | 181 | 397 | 2.1% | 13.2% |
| Thailand | 1,097 | 24 | 475 | 2.7% | 10.6% |
| Turkey | 1,487 | 120 | 242 | 2.5% | 14.2% |

| 4 Middle Income Oil Exporters | Net Annual Losses ($mil) | Estimated U.S. Economic Asst.1986 ($mil) | Net Official Development Asst.1984 ($mil) | Net Annual Losses as a Percentage of | |
|---|---|---|---|---|---|
| | | | | GNP 1983 | Imports 1984 |
| Peru | (148) | 55 | 310 | -0.8% | -2.0% |
| Egypt | (2,150) | 1,251 | 1,764 | -6.8% | -43.0% |
| Indonesia | (3,379) | 87 | 673 | -3.9% | -21.0% |
| Bolivia* | 20 | 51 | 172 | 0.6% | 1.8% |

*Bolivia, though a small scale exporter, appears likely to gain $20m annually.

Source: See footnotes to Table 2 for sources and assumptions used in calculations of estimates. Table 2 presents the detailed calculations underlying Table 1.

computations underlying the net gains and net losses shown in Table 1.

These estimates show that if oil prices remain in the vicinity of $15.00 a barrel for a year, the net effects will be significant for most of the countries represented in Table 1. Most of these ten low income countries would show gains in the range of 0.5 to 1.8 percent of their GNPs and in the range of 2.8 to 6.8 percent of their merchandise imports. These six middle income importers would show larger gains: on the order of 2.1 to 2.8 percent of GNP and of 8.8 to 14.2 percent of merchandise imports. The two oil exporters, Egypt and Indonesia, would face the biggest changes: losses of 3.9 to 6.8 percent of GNP and of 21 to 43 percent of merchandise imports (calculations for Egypt include both the Egyptian Government's share of oil output and that--excluded from some official statistics--of the producing companies).

Sudan and Bolivia stand out as exceptions. The very small net gains for Sudan would be due to likely reductions in the recently large number of Sudanese citizens working in the Gulf states and in the recently large flows of ODA to Sudan from members of OPEC. Although a small scale petroleum exporter, Bolivia appears likely to gain modestly from lower oil prices.

The prospective net gains of the low income countries loom large relative to U.S. bilateral economic assistance programs but modest compared with net ODA totals (i.e.; official development assistance from all sources, net of principal repayments). The prospective gains of the six middle income oil importers are larger relative to U.S. economic assistance and, in some cases, are large even when compared with total net ODA flows.

These four oil exporters have been receiving large foreign assistance flows. Nevertheless, Peru's prospective losses would be nearly half of its net 1984 ODA, Egypt's prospective losses would be 20 percent above its net 1984 ODA, and Indonesia's prospective losses would be over five times its net 1984 ODA receipts.

This analysis covers the principal consequences of a fall in oil prices of $11.50, but it is not exhaustive. For example, new borrowing will all be at lower interest rates. Real growth rates will be larger for most oil importers. Bolivia and Indonesia may lose revenue on their natural gas exports. The lower price may lead to further increases in quantities traded by the oil exporters. The assumptions behind the calculations are spelled out in detail in the footnotes of Table 2 so individuals can easily investigate the differences in estimated effects that would follow from different assumptions.

**Table 2:** Basis for Estimates, for each of 20 Developing Countries, of Net Annual Losses or Gains from a Fall from $26.50 to $15.00 Oil ($ millions unless otherwise indicated).

| | Basic Statistics | | | | | | | | | Annual Gains | | | Annual Losses | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | (1) | (2) | (3) | (4) | (5) | (6) | (7) | (8) | (9) | (10) | (11) | (12) | (13) | (14) | (13+14) | (10+11+12) |
| | | | | | | Merchandise Trade | | | | | | | | | | |
| 10 Low Income Oil Importers | Population mid-1983 (Millions) | Per Capita GNP 1983 (Dollars) | GNP 1983 | Net Annual Oil Trade 1985 (000 Barrels) | Total Med/Long Private Debt 1984 | Exports 1984 | Imports 1984 | Remittances In 1984 | Total Net OPEC ODA 1984 | Gains on Net Oil Trade | Gains Due Decline in Interest R | Gain From Increased Exports | Loss on Remittances | Loss of Net OPEC ODA | Losses from Change in Price | Gains from Change in Price |
| **Bangladesh** | 95.5 | $130 | $12,415 | -11,363 | $150 | $931 | $2,870 | $450 | $15 | $136 | $1.7 | $14 | $68 | $5 | $72 | $132 |
| Haiti | 5.3 | 300 | 1,570 | -1,700 | 93 | 450 | 687 | - | - | 20 | 1.0 | 7 | - | - | 0 | 28 |
| India | 733.2 | 260 | 190,632 | -62,050 | 4,330 | 10,257 | 17,502 | 2,500 | (105) | 714 | 48.7 | 154 | 250 | - | 250 | 917 |
| Kenya | 18.7 | 340 | 6,426 | -8,760 | 1,020 | 1,229 | 1,677 | - | 51 | 101 | 11.5 | 18 | - | 17 | 17 | 131 |
| Malawi | 6.6 | 210 | 1,386 | - 365 | 150 | 252 | 158 | - | - | 4 | 1.7 | 4 | - | - | 0 | 9 |
| Nepal | 15.7 | 160 | 2,512 | -1,095 | 26 | 67 | 256 | - | (1) | 13 | 0.3 | 1 | - | - | 0 | 14 |
| Pakistan | 89.7 | 390 | 34,983 | -42,705 | 1,500 | 2,556 | 5,952 | 2,400 | (41) | 491 | 16.7 | 13 | 360 | - | 360 | 546 |
| Sri Lanka | 15.4 | 330 | 5,082 | -12,410 | 675 | 1,436 | 1,246 | 270 | 5 | 143 | 7.5 | 22 | 27 | 2 | 29 | 172 |
| Sudan | 20.8 | 400 | 8,320 | -8,213 | 1,300 | 633 | 1,417 | 470 | 113 | 94 | 14.6 | 7 | 71 | 37 | 108 | 113 |
| **6 Middle Income Oil Importers** | | | | | | | | | | | | | | | | |
| Zimbabwe | 7.7 | $740 | $5,846 | -1,825 | $1,350 | $792 | $761 | - | $1 | $21 | $15.2 | $12 | - | $0 | 0 | $46 |
| Honduras | 4.1 | 670 | 2,747 | - 5,110 | 650 | 778 | 827 | - | 15 | 59 | 7.3 | 12 | - | 5 | 5 | 78 |
| Morocco | 20.8 | 760 | 15,808 | -32,376 | 4,500 | 2,117 | 4,054 | 910 | 7 | 373 | 50.6 | 32 | 9 | 2 | 11 | 455 |
| Philippines | 52.1 | 760 | 39,576 | -52,195 | 13,000 | 5,343 | 6,252 | - | (0) | 600 | 146.3 | 80 | - | 1 | 1 | 826 |
| Thailand | 49.2 | 820 | 40,344 | -81,140 | 6,000 | 7,401 | 10,349 | 687 | 18 | 933 | 67.5 | 111 | 9 | 6 | 15 | 1,112 |
| Turkey | 47.3 | 1240 | 58,652 | -127,055 | 6,400 | 6,725 | 10,530 | 1,300 | 33 | 1,415 | 72.0 | 101 | 90 | 11 | 101 | 1,568 |
| | | | | | | | | | | Annual Losses On Net Oil Trad | Annual Gains | | Annual Losses | | (10+13+14) Losses from Change in Price | (11+12) Gains from Change in Price |
| **4 Middle Income Oil Exporters** | | | | | | | | | | | | | | | | |
| Peru | 17.9 | $1,040 | $18,615 | +24,745 | $7,276 | $3,330 | $2,553 | - | - | $230 | $81.9 | $50 | - | - | $280 | $132 |
| Egypt | 45.2 | 700 | 31,640 | +169,500 | 5,000 | 4,731 | 14,556 | $4,300 | (55) | 1,347 | 56.3 | 71 | $430 | - | 2,277 | 127 |
| Indonesia | 155.7 | 560 | 87,192 | +779,875 | 16,100 | 21,831 | 13,830 | 59 | 15 | 7,274 | 181.1 | 328 | 9 | $5 | 3,688 | 509 |
| Bolivia | 6.0 | 510 | 3,060 | +150 | 1,120 | 610 | 714 | - | - | 2 | 12.6 | 9 | - | 0 | 2 | 22 |

Footnotes to Table 2

These footnotes refer to columns identified by the number at the top of each column. The footnotes for columns 1-9 give data sources. The footnotes for columns 10-14 report the assumptions used in calculations of gains and of losses.

(1) World Bank, World Development Report: 1985, Washington, 1985, p. 174.

(2) Ibid.

(3) Calculated as (1) times (2).

(4) 1983 data from Department of Energy updated to 1985 by Agency for International Development.

(5) Central Intelligence Agency data file.

(6) International Monetary Fund, Direction of Trade Statistics Yearbook, 1985, pp. 3-7.

(7) Ibid.

(8) International Monetary Fund, reports on individual countries.

(9) Organization for Economic Cooperation and Development, Geographical Distribution of Financial Flows to Developing Countries, Paris, 1984, country pages.

(10) Assumes the volume of oil trade to be exactly the same as estimated for 1985 in (4). Assumes actual 1985 price, after discounting, was $26.50 a barrel while the new price is $15 a barrel. Therefore, savings (for oil-importers) or losses (for oil exporters) are $11.50 times figures in column (4).

(11) Assumes one half of each country's private medium and long term debt is at floating rates and that interest rates will be 2.25 percentage points lower than otherwise. Therefore, savings for each country are .0225 times one half of the figure in column (5).

(12) Assumes that the growth rate of OECD countries will be higher by 1.5 percentage points than otherwise and that merchandise export values of the developing nations will also be 1.5 percent larger than otherwise. Therefore, added income for each developing country is .015 times column (6).

(13) Assumes remittances will not fall for the Philippines but will fall by 1% for Morocco, and Thailand, 5% for Turkey (this number is inflated to allow also for reduced merchadise exports), 10% for Egypt, Sri Lanka, and India, and 15% for Sudan, Indonesia, Bangladesh, and Pakistan. Each number in column (13) is the relevant figure in column (8) less the assumed percentage reduction.

(14) Assumes a cut of one-third from the net official development assistance levels from OPEC members in 1984. Therefore, the loss is 0.333 times the figure in column (9) for the countries with positive net ODA flows from OPEC countries in 1984. Assumes no change for reecipients with negative net flows from OPEC countries in 1984.

## REQUIRED PERSONNEL LEVELS TO MANAGE HEALTH-RELATED PROGRAMS

You made a great deal of the rehydration program for infants in your opening testimony—one of the organizations that has been very directly involved in that oral rehydration program is UNICEF.

Yet, the Administration, in its request to fund the new AID proposal for Ireland—because of the agreement between the British and the Irish, the Administration is suggesting that that can be financed by an offset in rescissions which are suggested including a rescission of funds for UNICEF.

I think you are asking for a reduction of about $17 million in UNICEF. I find it difficult to understand how we can give such emphasis to the importance of this program, then cut back on UNICEF's budget from the amount appropriated by Congress.

I also note that in your priorities for this year, agriculture is supposed to go up—the agriculture account is supposed to go up by 6 percent; population by 4; education up by 11; energy projects up 30; science and technology projects up 38 percent; health down 22 percent.

I am talking about for the Gramm-Rudman level. I don't want to get into that argument. I am leading to a different question.

I understand why the Administration is concerned that the health account is not able to spend money efficiently, because in many cases you don't have adequate personnel to apply that money well.

My question is this. If you are talking about immunization programs, for instance, and talking about programs like this, and if you don't have the adequate personnel needed to do the job, could you tell me how we can get that personnel?

Can you tell me, for instance, what increase in personnel would be needed in order to adequately deal with this program, with the immunization program and other similar childhood related programs?

Mr. MCPHERSON. The principal reason that I have come to this committee with the numbers that I have is not because of personnel. That is an operational problem that I have to deal with, but not a reason for the numbers.

The principal reason is that I think that there needs to be a balance between these various accounts. I don't want to cut back on agriculture and, as a result not be able to increase agricultural production as much as I think it can be increased in order to fund health, because one of the key elements of good health in children is decent food. We find as incomes go up and agricultural production goes up, kids eat a lot more food.

### FUNDING PRIORITIES

Mr. OBEY. I understand that rationale. But my point is you brought that chart up. You brought those pictures up. I didn't.

And a major part of your testimony was the importance of programs like this, but then we see a reduction of 22 percent in the agriculture account.

Mr. McPherson. I did that for a couple of reasons.

I did it because there has been tremendous attention given by Congress to immunization, and I think we need to view immunization as a partner, one of the twin engines, to ORT, and I wanted to make that point to this committee.

Mr. Obey. Are you suggesting Congress is putting too great an emphasis on immunization?

Mr. McPherson. I think they need to put emphasis upon both instead of just on one, yes.

I believe now that I have worked that out with the WHO and UNICEF as an international strategy.

Mr. Obey. You think the best way to deal with that is, for instance, to cut back on your health account and cut back on UNICEF's account, while the rhetoric is about what we are going to do for kids?

Mr. McPherson. We are spending more money on health, substantially more. There is a substantially higher request from the Administration for health this year than last year.

I made a very conscious——

## DIVERSION OF FUNDS BY FOREIGN GOVERNMENTS

Mr. Obey. That is the request. But again, I went through this with the Secretary yesterday.

If my son came to me and said, "Dad, I want a $1.50 for an allowance this year," and I said, "Well that is a big increase," you say, "No, it is only a five percent increase."

You are talking about getting 50 cents. And he says, "Yes, but I asked for a dollar last year."

That is the logic the Secretary used yesterday in describing what your request level was.

We are not dealing with request levels. We are dealing with what money we actually have and from the levels the members have decided—let me ask you a different question, because my time has expired.

There is a tremendous degree of interest in the Congress and in the country about the incredible amount of money Mr. Marcos seemed to be ripping off. We understand—I fully understand the position of the Administration in telling Marcos to come, bring your friends. It was a small price to pay to get him out of power.

But without getting into all of the legalities about what we are going to do about what he has ripped off—my question is this. We are going to have more Marcos' down the line. We have got a lot of autocrats running a lot of countries around the world, and a lot of them get money from us.

I guess my question is this. One year, two years, three years down the line, we are going to see other people leave power. A lot of them have ripped off a lot of money, and our taxpayers are going to be saying, Good God, if you take all the money we put into the Philippines over the last ten years compared with what Marcos took out, we would come out second best, according to some of the members.

My question is, does your operation, with your programs, make any estimate of the kinds of resources we are putting into those countries versus the kind of resources being routinely diverted from the public treasury by some of the governments in the countries we are providing aid to?

Mr. McPherson. We don't have any estimates of that. Diversion isn't subject to accounting, of course——

Mr. Obey. Not that traditional sense, but obviously our government somewhere must have some view of what the magnitude is.

If we don't, we shouldn't be in business.

Mr. McPherson. I don't think we have any numbers that would satisfy this subcommittee. There is, clearly, as a result of the level of development in these economies, some diversion. I think what we can do, and the best way we can protect ourselves is to be able to track as best we can, and we think we can do so reasonably effectively, the use of our own money.

Mr. Obey. With all due respect, I don't agree with that.

With all due respect, our taxpayer is going to feel, and I feel, that it doesn't do us a blessed bit of good if we are putting double digit aid programs into a country and that leadership is taking triple digit ripoffs out of the country, putting it in Swiss banks and New York real estate or anything else.

That is not your fault, and it is not anybody's fault in this government, but I think we have given the budget stringencies.

I think we have to start adding—we have to add another consideration to our list of considerations which we use to determine who is going to get aid money.

It seems to me one of them we have to ask is, are we really having a net effect on that economy, or are the people running it, draining it faster than we can fill it up?

Because—and if we have a judgment about that, it seems to me that no matter how strongly we feel about the people in that country, it is a futile effort to provide aid to that country if the government is ripping off more than we are putting in.

What I really ask you to do is—I would like to know again if you will take the 25 countries that receive the largest amount of aid under your shop—if you could give us—if you could make some effort to talk to our national security people, our intelligence people and others, and try to get some idea of the total volume of rip-off in some of those countries, or at least examples of diversions taking place, and compare that to the amount of aid money we are putting into those countries.

Mr. McPherson. We would be happy to try and do our best to do that.

I am sure that will not be an easy assignment.

Mr. Obey. It is a very difficult assignment, but I would be flabbergasted if we don't have some rough estimate of at least the minimum amount that we expect some of these guys to be ripping off.

Mr. McPherson. Let me respond substantively and candidly to your comments. I know that you have several colleagues who will have questions, but I think this is a very important problem—

Mr. Obey. The point I am getting at is, if we are going to be pulling the plug on the population programs, we don't like the way countries are using population money for—not our own money, necessarily—it doesn't seem we should use that for just population, but for every program in this bill.

Mr. McPherson. I think there are a number of things that we have been doing and, frankly, perhaps should do even more to address the point of being sure that our funds, in form and in substance, aren't diverted.

One safeguard I mentioned, are the accounting systems. You and I both understand what that means. As a result of technical accounting, we are quite confident that our money wasn't diverted in the Philippines. There are GAO audits, IG audits and so forth.

Beyond that, there are several different options you have in dealing with a country.

One, you can do as we did in Haiti, where a substantial portion of the program went through non-governmental sources. About 50 percent of the program in Haiti went outside the government because of our deep distrust of that government.

Mr. Obey. My time is up, and I don't want to pursue it.

My point is, you are not answering my question, Peter, with all due respect.

You are still focusing on how we protect our AID money and, obviously, I want at least that done.

I think we have got to get beyond that to look at the broader question of whether this money in any individual country is doing one damn bit of good or not, given the other trails in and out of the economy we ought to try to track.

I am very serious about that.

Mr. McPherson. Let us think about that. But can I make a couple of other comments?

Perhaps I am focusing too narrowly. The other comments are that we believe that cash flight from a country is almost always related to overvaluation of exchange rates and to fundamentally bad economic policies in the countries——

Mr. Obey. I am not talking about people investing their money for intelligent economic reasons.

I am talking about people stealing. I am talking about government officials stealing from their own treasury while we partially replenish those treasuries with aid.

Mr. McPherson. The last point I was going to make is that I think we need to look at the quality of government in AID-recipient countries. That needs to be one of the bases, and indeed, I think is, one of the bases on which we decide whether or not that country should get assistance.

I think that has to be a factor. We sometimes give monies to countries for foreign policy reasons that, frankly, if we had our choice, we wouldn't give money to at all.

That is clear. We have tried to do that from the very beginning, perhaps we need to look at it even harder.

[The information follows:]

### STUDY OF CORRUPTION IN A.I.D.-ASSISTED COUNTRIES

I will be conferring with my colleagues in the State Department concerning the feasibility of such a study. We will be happy to consult with you after we conclude our deliberations.

Mr. Edwards. Peter, let me begin by first echoing something the Chairman has said. I think he is on a key point.

The need is not necessarily to trace what happens to the money we appropriate. In El Salvador, we had debates about whether it should go through the Central Bank or whether there should be some sort of special accounting. The important thing is, if you appropriate money to any government, we ought to make sure the money we appropriate is doing some good. And I think that the Chairman's point was, if we are putting in this much money over here and somebody else over here is taking out more—you know money is fungible, but the net impact of what we are doing is not helping that country very much.

We ought to be putting our resources somewhere else. I urge you go back and look very seriously at how we can do a better job of determining what nations will be recipients of our programs based not just on their policies, but on whether or not we can see that our aid is doing some good.

I might also say—I know the Chairman will disagree with me on this—that I have pushed for so long to move from an emphasis on multilateral agencies to bilaterals ones precisely because I believe we can show better results in a way that serves U.S. interests, and within the bilateral framework I would like to see us more closely pinpointing what the money is used for so we can control it and make sure that we are buying what we think we are buying.

### A.I.D. PRIVATE SECTOR INITIATIVES

Let me ask you a couple of questions about something that is very dear to my heart, and that is the private sector initiatives within AID. One of the things that I have heard which has given me reason for concern—is that there may be within AID a problem with being effective in dealing with the private sector, simply because there aren't enough people within the agency who have private sector expertise.

I would assume that most of the people who are in the agency are people who have been with the government for a long time. Many of them who I know personally got out of school and wanted to do this because it is a way to "do good," just like joining the Peace Corps or something else, so they went into government service, and all of their careers have been geared toward administering government-to-government foreign assistance programs or other programs like that.

When it comes to dealing with the private sector, they don't have the background. I have heard that from some people in AID.

I wonder if you could comment on that? Do you have currently within the agency the ability to carry out a private sector initiative?

Mr. McPHERSON. Let me first, if I can, return to your opening comments. I obviously want to respond to this question.

I believe that AID has to do more than trace its money. We have to have more accountability. We have to be responsible for whether or not we are delivering a net additional product, such as health, to a country.

So, one of the things that we always look at is, are we going to do something which nobody else could do? In the family planning area, we don't go in and try to substitute what a government could do or what somebody else will do; we talk about net additionality. It is a very important part of what we do. Once we decide we are going to put money in to net additional resources—resources that otherwise wouldn't be available for that activity—then we try to set up measurements of success or failure.

One of the advantages of putting efforts into something like ORT or various agricultural production projects is that we can go back and say how many lives we have saved, or measure what happened to agricultural production.

I am looking for net additionality as well as accountability for money, and that is a new concept. That is a concept which I always kept in my mind, and I think our programs are very geared to that.

As to the private sector——

Mr. OBEY. Would you mind switching mikes?

Mr. EDWARDS. Before you comment on the private sector thing, let me comment on one point.

Many programs—you are giving cash grants to Egypt, for example—involve trying to tie some forms of conditionality to them. I think that is a good thing.

Mr. MCPHERSON. I feel strongly about that.

Mr. EDWARDS. But it also seems that when you look at a government as a potential recipient, the lack of corruption or the presence of corruption in that government—in terms of siphoning off large amounts of foreign aid—may not be one of the factors. Is that true?

Mr. MCPHERSON. I believe that is right. I concur with that.

Mr. EDWARDS. Also, before you address the private sector, I wonder if I could ask an additional question.

When you say net additionality, is "additionality" a word?

Mr. MCPHERSON. It is a word we use often.

Mr. LEWIS. It is like "sequestration."

Mr. PORTER. All right.

If you would address the private sector.

Mr. MCPHERSON. Over the last several years, we have been able to institutionally respond to our private sector initiative. In my judgment, we have been doing better and better. We start off as any government agency does, with a bias, in favor of dealing only with other governments. It is the nature of government.

When you have had a career in government, and when you have had a history of only dealing with governments, it is natural to do so. It is also in the nature of the World Bank and the regional banks to do so, in my judgment. It is a real struggle, frankly.

How have we attacked this? We have set up training programs for our people inside and trained them by having private sector people come in and deal with the issues. We have had individuals from the private sector go around the world and work with our missions. We have been able to recruit some very good outside people who have helped on this.

Most important, we have gone outside the agency to get groups of contractors, like the Young Presidents organizations and others, who have served as our agents in this process. We are really doing some interesting things now and our privatization effort is really beginning to take off. But it has been a struggle.

We struggled at the very beginning institutionally, but that is not where we are now.

Mr. EDWARDS. There are two parts involved in carrying out this initiative. One of them is what you are talking about in terms of getting people in place who have some experience in the private sector. You say you are getting outside resources to help you.

The other part is the programmatic area in determining what you are going to do. For example, are the projects being initiated today under the Bureau for Private Enterprise very different from the ones we were funding in the Fifties and Sixties before we created the Bureau? What are you doing differently through the Bureau of Private Enterprise than we were doing previously, and what kind of emphasis is being put on PRE recommendations within the overall context of AID strategic planning?

I notice in this year's total AID bilateral request, $6.242 billion of it is for PRE, which is still a tiny fraction. I wonder if you can give me a better estimate of what kinds of projects—how much effort is being put into it, how much money, what are we doing with the private sector initiative?

Mr. MCPHERSON. I have always seen the PRE Bureau and our Revolving Fund as an experiment—as a place to develop ideas and concepts—and not in any way the only place for development of private enterprise projects.

I kept it small because we really have decentralized field operation. It is the only way we can get things done, in my judgment. So, the bulk of the money ought to be and is in the individual missions.

What we are doing differently now than probably what we did in the Fifties and Sixties when there was some private enterprise activity, is that we have a placed major emphasis on privatization—moving government enterprises into private hands. We are probably doing more venture capital oriented loans and activities than have been done at any other time in the history of this Agency.

However, those sorts of activities are not unique. We have given LAD as much money as we mutually think LAD can use. We think this has been an excellent use of our money and now LAD is no longer unique in the agency.

Mr. OBEY. The gentleman's time has expired.

Mr. McHugh.

### REQUEST FOR REPORT ON FOREIGN GOVERNMENT CORRUPTION

Mr. MCHUGH. Thank you, Mr. Chairman.

First of all, Peter, welcome. And I would like to second the remarks of our Chairman earlier, and Mr. Kemp, about the fine job which you and your agency does.

I would also like to focus for one moment on the issue of corruption. It is obviously relevant, and one of those things which all of us on a bipartisan basis can agree on. It is important in making tough decisions about allocation of limited resources to have this piece of information.

We do have to make some tough decisions about where these limited resources will be allocated.

Even if our aid program is sound and provides that net conditionality you are talking about, nonetheless the credibility of the program is eroded by virtue of that corruption, even though we are not tied to it directly.

Perhaps the Chairman may want to think about this, as well as yourself. I would suggest that for your presentation in fiscal year 1988, in addition to what has already been suggested, you or the State Department—because this affects not just AID programs but our foreign aid programs generally, including the military assistance—submit to us a classified report on the nature of corruption, if it exists, in recipient countries.

This is not the only consideration, but I think it is important. And I realize it is a sensitive matter. If this were open, it would be difficult for you to be candid, and it may be something that you can't do in an effective way.

I think if you are able to provide us with a classified report on the nature of corruption, if you can quantify it as the Chairman has suggested, I think it would be particularly helpful. But even if you can't, how governments in a particular country operate and the level of corruption, or the nature of corruption that exists, I think, is relevant and helpful to us.

Mr. Chairman, I would hope that we would urge he think about this, in consultation with the Secretary, and would consider doing this for our benefit, as well as your own.

Mr. McPherson. If I can comment, we would be happy to think about that and perhaps, informally, we can get back together and sort this out. The credibility of the foreign aid program needs to be safeguarded; the substance needs to be safeguarded.

I have always taken corruption concerns into consideration, because, obviously, what we want is to use every dollar as effectively as we can. But we would be more than happy to review this, because it is obviously timely.

Mr. McHugh. I realize it is easy to sit up here and make these suggestions, and you folks have to go back and spend countless hours doing this. Nonetheless, it is important.

Mr. McPherson. We should view ourselves essentially as development bankers. We need to see ourselves as people investing money in growth and in change. We ought to look at the return on the U.S. taxpayers' money for the U.S. taxpayers' goals, and, in effect, make our money conditional. We ought to look at how many childrens' lives are saved; how much additional agricultural production you achieve; and how much policy change is achieved.

I think these are the kinds of things we ought to look at. The development banker concept is one that I have used in speeches since I have gotten here.

Mr. Lewis. I like you a lot. But when you start becoming a banker, I am going to wonder about you.

### JUSTIFICATION FOR ASSISTANCE LEVELS TO CENTRAL AMERICA

Mr. McHugh. You recall yesterday, when the Secretary was here, we talked a bit about what we have provided to sub-Saharan Africa and Central America. These comparisons are imperfect, and there is always more complication than we can cover in a timely manner.

One of the tables that we have prepared—and I think I provided it to you—indicates that from 1981 until now in real terms the bilateral economic assistance for Central America has increased by about 185 percent, in real terms, over and above inflation.

During the same period, our bilateral economic assistance for sub-Saharan Africa has increased in real terms by 2 percent.

Now, again I recognize that there are more relevant factors here than simply the economic and development problems in the region. We have political considerations, strategic interests, which are reflected in the Central American number.

Nonetheless, as you said yesterday, focusing on the development and economic needs of the regions, one has to conclude the situation in sub-Saharan Africa is substantially more desperate than Central America.

I am not quarreling necessarily with the economic assistance for Central America. I support it, for the most part, for all the reasons we have referred to. Our interests there are significant.

Nonetheless, I think we have to ask ourselves, at a time of tough choices, whether or not we are achieving what we need to achieve. We have provided in that period of time between fiscal year 1980 and 1985 more than $3 billion in economic aid to Central America, and more than half of that has come in the last two fiscal years.

Your budget document indicates that we will commit another $820 million in economic aid during fiscal year 1986. And your request for fiscal year 1987 is over $1 billion in economic aid.

The second chart which I give you, which I think is your chart, shows the economic growth rates in Central America between 1980 and 1985. And the primary purpose, I think, that we provide an increasing amount of economic assistance to Central America is to try to promote economic growth, and therefore stability. And, again, I don't have any fundamental quarrel with that.

But if you look at the numbers, it would indicate that we haven't seen much economic growth in Central America. I recognize the conditions are different in each country and there are things which contribute to economic growth or the lack of it beyond our own economic aid programs.

Nonetheless, I think it is important for you, since we must decide where our limited resources are allocated—it is important for you to respond to this. We have provided substantially more aid, and yet economic growth is not reflected.

Can we justify increasing even more the economic assistance for these countries?

Mr. McPherson. I would like——

Mr. McHugh. Relative to problems of other parts of the world and our budget problems?

Mr. McPherson. I have thought a great deal about this. The Africa figures are somewhat skewed because they don't include Public Law 480 assistance. In FY 1985 when you include PL 480 Title I assistance—the non-drought food—for Africa, you approach a billion dollars for Africa.

Last year, of course, we had substantially more than a billion dollars for Africa because of the drought. But PL 480 Title I should be included as economic assistance. It was one hundred eighty-two million dollars for Title I.

Mr. McHugh. That is true, Peter; I can see that. But in development terms when you compare Africa with Central America, you still have—the drought was an emergency. We responded to it generously. And that is relevant. But in development terms, we have these continuing desperate problems, and one has to wonder whether or not this is a fair allocation of resources.

Mr. McPherson. Now, let's look at the Central America growth rates, which of course I am intimately familiar with because we watch them all the time. In FY 1984 there was some good economic growth—we think short-term factors affected the rate. We think the growth rate will rise a couple of percentage points again this year.

Although Guatemala's economy began to fall apart, we have now had an election and we are now hopeful that the Guatemalan economy will turn up.

We should first note that we have democracies throughout most of the region—Nicaragua being an exception. Just look at the elections in Guatemala, Honduras—those are very impressive results. And I am quite confident our monies were an important part of helping that all occur. We can really be proud as Americans what we have done.

Second, before we began with the Jackson Plan, the Central American economies were plummeting. In El Salvador, there was a 30 percent drop in GNP—just a tremendous drop.

We have been able to stabilize those economies. If you look back you can see what was happening. We have been able to stabilize their economies and increase the growth rate. I think 1986 will be a better year than 1985 was, in at least some of the countries.

Mr. Obey. Peter, can I ask you to wind it up? We are not going to get through all of the Members if you don't keep your responses shorter.

Mr. McPherson. I will be briefer, Mr. Chairman.

We have been able to have some real impact upon the lives of people. For example, the child mortality rate in Honduras has probably fallen 15 per thousand deaths compared to where it was when we first put programs there in a big way.

Mr. Obey. Mr. Kemp.

## POLICY TOWARD EL SALVADOR

Mr. Kemp. Thank you, Mr. Chairman.

I had a chance to welcome you earlier. I had to go to my office a few moments and just came back in time to hear you say that you want to play the role of development bank for the world.

With all due respect, if you look at countries who have tried to generate economic growth with massive development banks, either in their own country or in the world, they are not nations who have a great record in achieving economic growth.

But it is interesting that all of us, right, left and center today are talking about growth, and that is a step in the right direction.

I think you will find very low correlation, in at least the evidence I have been looking at, between U.S. foreign aid and economic activity along the lines you alluded to earlier. It doesn't mean there isn't any correlation, but I would say it is a low correlation.

In other words, what countries do on their own with American help means far more impact upon their economies and their chance for non-inflationary growth than the redistribution of income. I am not against redistribution of income in certain cases where we have an obligation to the poor, to the ally, to a friend, to some part of the world we are trying to build a bridge to. But we should not make the mistake, in my view, of suggesting the American taxpayer can play a role as development bank for the rest of the world.

We have something called the World Bank and soft loan window, and your answer to Mr. McHugh should have been beyond Public Law 480, Central America gets no 50-year low interest loans, or no interest loans; Africa does. I shouldn't deny it should do that.

If you take the World Bank item, it isn't true between Africa and Southern Asia—a vast majority of those monies are flowing in terms of 50-year no interest loans, which are not factored into those bilateral programs between the sub-Saharan and Central America.

Recognizing the needs of our hemisphere is incredibly important to the security of ourselves and those neighbors, and notwithstanding our other problems I favor the Jackson Plan and was pleased to have been a part of the Kissinger Commission, and I favor a marshall program for Central America, both from security and economic development.

I want to get back to this question of what fosters growth, because without saying there is anything handed down in tablet form at this point it seems to me increasingly clear that you are going to have to come to some decision soon as to whether you are going to, on the one hand, promote privatization, promote freer markets, promote lower tax rates, promote more economic activity and trade and, on the other hand, have it countermanded by the IMF which is going in and telling those same countries to devalue their currency, raise their taxes, and to compete in a "beg for thy neighbor game" for a bigger piece of the shrinking pie, to which James LaMoyne in the New York Times—wrote on El Salvador—they had a pretty good economy in the Sixties under the Kennedy Plan of the Alliance for Progress, promoted trade, promoted open markets, a common currency, a common market between the countries of the Isthmus.

The Seventies were terrible, and the early Eighties were terrible. Listen to this in LaMoyne's lead: "What is shaping up," he says, "is a major political test for Jose Napoleon Duarte"—and here we liberal democrats, conservatives and republicans all recognize the hope of Central America is to build up a democratic center to have a strong Jose Napoleon Duarte both politically and economically.

Listen to this: He is prepared to announce a series of sweeping economic measures that include raising taxes and devaluing the currency. Devaluation is at the heart of the new economic program of El Salvador.

The United States Embassy and State Department is lobbying hard for devaluing the El Salvador currency, which is, they say—which is in this New York Times article—a necessary medicine for an ailing economy. How many places in the world have we seen the same advice given? Devalue your currency; remove your taxes to remove the fiscal deficit. It ends up punishing the people in the country, sending unemployment rates and interest rates up.

We have a chance of seeing some success in Central America, but at the same time it seems we are giving bad advice. It goes back to my opening statement, which was when William Raspberry wrote in The Post that we made virtually no effort to support the American economic system, it is as though we are apologetic for our own economic system here at home, and we are trying to encourage investment and savings and entrepreneurship and lower interest and tax rates.

But in El Salvador, a country with whom we have a tremendous stake strategically as well as morally, we are pursuing a policy that is at odds with what you know to have not worked or to have worked in the last three years.

Why?

Mr. McPHERSON. The Duarte Plan, as it was adopted, had some things which we liked and some things about which we had questions. For example, there were price controls that he imposed on a number of agricultural commodities, and we clearly had some concerns about that, because we think that, over time, such price controls will reduce production by farmers.

The plan placed, I think, a couple hundred of items on a list of items which could not be imported, which is a matter of real concern to us.

### MONETARY POLICY IN EL SALVADOR

Mr. KEMP. Who in the U.S. Embassy is lobbying hard for another devaluation of the currency and raising taxes in El Salvador?

Mr. McPHERSON. Taxes, I think, are a real problem. I think that it is important for President Duarte to cut some government expenditures in order to reduce the deficit.

Now, as to the devaluation, a matter about which you and I have not agreed previously, I think controlling the valuation of currency is as bad as controlling the price of food or other items.

Mr. KEMP. Peter—

Mr. McPHERSON. And, as such—

Mr. KEMP. Peter, excuse me.

Mr. McPHERSON. Yes, sir.

This is a matter which I know we don't agree upon, but I know that you don't agree to controlling food prices and that you don't agree in controlling prices generally.

Now, a fixed exchange rate, which is artificial, which is over and above black market prices—

Mr. KEMP. Let's debate this some other time. You and I disagree on that. I think the government that owns the monopoly power over the issuance of a currency has an obligation both morally and economically to protect, defend and preserve the value of that currency. They have an obligation because they hold the monopoly power over issuing the currency.

To say you are going to let the rate of the currency be set in the marketplace is to deny the fact someone has to set a standard. You can't have a ruler one day 13 inches and the next day 9 inches. You have to have an accounting.

Be that as it may, Mexico, Haiti, Sudan, Ethiopia, Philippines—I can name you many, many countries in which we have participated with the IMF telling those countries to devalue the currency. Whether you and I end up winning each other over—setting that aside, you know the devaluation sent up interest rates and prices and explicitly raises tax rates on the factors of production.

Mr. McPHERSON. It is true that the devaluation, in the short term, usually increases prices.

Mr. KEMP. And interest rates.

Mr. McPHERSON. Usually.

And it is also true that devaluation creates export jobs.

I think, Congressman, to argue effectively in El Salvador about devaluation, with great domestic results, you must address its impact on jobs. We have to create jobs in these poor countries. New jobs largely are created by exports.

Mr. KEMP. That is crazy. It is not for us to decide which those jobs are.

Do I have any time left?

Mr. OBEY. About 30 seconds.

Mr. KEMP. They are raising their prices on coffee exports. Here you have a drop in the export price, a drop in the price of coffee, and an increase in export prices at a time you are evaluating a currency. It is counterproductive.

Mr. McPHERSON. We believe the El Salvador INCAFE coffee monopoly should be broken up, and we believe in further land reform.

I talked about both issues to President Duarte just recently, as a matter of fact. I think the business community in El Salvador tends to believe that the solution to the issue of coffee lies in the reformation of INCAFE.

### POPULATION POLICY

Mr. KEMP. As someone critical of the population control policies, let me say on page 7 and page 8, I want to compliment you on your policy, your testimony with regard to family planning and your statement about coercive abortions. This is a step in the right direction, in my view, and we should be on the side of family planning internationally, and obviously not on the side of coercion.

Your strong statement is very welcome to Members on, hopefully, both sides of the aisle, that we want to play an active role in helping countries deal with these problems and not coerce people.

It is a marvelous statement, particularly compared with some of the problems that happened in the past. I thank you for that and look forward to continuing our dialogue.

Mr. OBEY. Mr. Dixon.

Mr. KEMP. Thank you, Mr. Chairman.

Mr. DIXON. Thank you very much, Mr. Chairman.

Mr. McPherson, several Members have paid tribute to your fine skills this morning, and I certainly want to join in doing that, but also want to compliment your great staff, particularly your congressional liaison staff.

Mr. McPHERSON. I agree with that.

Mr. **Dixon**. Let me ask three or four questions very quickly on issues I am sure you are familiar with, and allow you time to respond to them.

### CORRUPTION IN THE PHILIPPINES RELATING TO AID FUNDS

First, I wasn't clear when the Chairman was pursuing the issue of the Philippines whether you were saying without qualification that there has been no corruption in the AID program in the Philippines.

### ADDITIONAL ASSISTANCE FOR HAITI

Second, I know that there has been discussion in the Administration concerning Haiti and the request for some additional aid. I am wondering if this would be a reprogramming or what form would it be, what amount is under discussion, and what do you think it should be used for at this point.

### TRANSPORTATION OF FOOD IN AFRICA

Third, there has been some conversation and controversy concerning the AID program as it relates to transportation of food in Africa, the 50 percent formula. I wonder if you could give me the parameters of that and tell me what the policy is based on.

### AID POLICY TOWARDS LIBERIA

Certainly last, but not least, is the issue concerning Liberia. As you know, both Houses have passed a resolution expressing a sense of Congress. What is AID's position regarding the resolution and assistance to Liberia.

I have a question I would like to submit to you, concerning the Middle East Regional Cooperation Program and would appreciate your response in writing.

Mr. **McPherson**. I look forward to receiving that question in writing and will respond, Congressman.

First of all, as to the Philippines, both the GAO and my own Inspector General have, at several different times, looked at our program in the Philippines. We feel that our money has been well taken care of. There are broader issues that we have discussed here, but we feel our money, with very few exceptions, if any, went for what it was supposed to go for.

As for Haiti, there are a number of needs in Haiti. My Assistant Administrator for Latin America was there last weekend. We have been working vigorously to work this thing through. A new commitment made since the change of power is to deliver 15,000 tons of food for Haiti, which we hope to have in the country very soon.

What additional resources, if any, that will be available is something we haven't worked out. We have, I believe, a $50 million program there. We want to be sure it does the right thing. It has been quite an effective program. We planted several million trees last year and reached thousands of people with a good agriculture program. We will be happy to keep you informed as our needs assessment proceeds, because I know you have been very interested.

Mr. DIXON. Isn't there discussion about a new request—a new influx of money?

Mr. MCPHERSON. Well, there is a question about what exactly is needed and how that need might be met.

Mr. DIXON. No. My question was, hasn't there been a discussion about it?

Mr. MCPHERSON. We have certainly discussed the needs of Haiti. One of the needs is petroleum, and whether or not that could be, for example, obtained from a petroleum-producing country.

The whole issue of Haiti's needs are ones we just haven't completed, Congressman, and that is why I am not responding any further.

The one thing we have done in terms of providing new resources is the 15,000 tons of food, valued at $3 million to $4 million. We are going to be sure that there is money in the pipeline and for ongoing programs and new monies to be allocated will used for the best purpose.

The Secretary made a determination to allow the ongoing programs to continue a few days ago, as you know.

In terms of in-country transportation in Africa, our policy has been that in-country transportation is not paid for by AID. Last year was the exception, particularly in Ethiopia.

Mr. DIXON. There was language in the emergency food aid bill that provided $225 million reserve fund for transportation.

Mr. MCPHERSON. That is correct; you are speaking of the $225 million reserve fund.

What we have done this year, especially in Ethiopia and Sudan where there is a bigger problem than other parts of the country, is said that we would like to pay for 50 percent of the transportation needs, and that we would ask other parties to pay for the other 50 percent.

There was quite a large amount of money raised by everybody, from Band-Aid to U.S. Aid for Africa to Catholic Relief Service, who have said that they will provide us money so we can deliver food to Africa. And since we were providing almost all the food that these groups were using, we thought it was reasonable that some of the money they raised be used to pay for part of the transportation.

Mr. DIXON. And private voluntary organizations believe their money should be used for goods rather than transportation cost; is that it?

Mr. MCPHERSON. They have taken that position. It is my judgment that this issue is largely resolved, including the CRS portion of it.

I have had extensive discussions with Mr. Pursugo and others on this point as recently as yesterday.

As to Liberia, I am, of course, very aware of the House and Senate's sense of Congress resolutions which differ slightly from each other but are substantially the same. There have been problems such as with the release of political prisoners.

As you know, Jackson Goesh has been freed, and three American human rights observers are now in Liberia to observe the legal proceedings for the release of the others.

However, there are problems. Looking at the Johnson situation, in terms of freedom of press, there now appears to be a reasonable amount of freedom of press. But those judgments can be somewhat subjective, and we are still concerned about that.

Regarding the independent judicial system, there are some plusses but there are still problems. We have not released any further funds this year, and that will be something that we will continue to struggle with. I am sure you will hear more about it as the weeks go forward.

Lastly, we look forward to providing the Middle East information.

Mr. DIXON. Thank you, Mr. Chairman.

Mr. OBEY. Mr. Lewis.

### CORRUPTION IN THE PHILIPPINES

Mr. LEWIS. Thank you, Mr. Chairman.

Mr. Chairman, you and others, Mr. McHugh as well as Mr. Edwards, raised questions today that have been a part of my own concern for a long time about our foreign assistance programs in general. I can guess if there would be a fundamental thesis it would be how do we effectively measure whether the money we deliver in all of our assistance programs—whether they be bilateral or multilateral—how do we measure whether those dollars get to the people we purport to want to help in the first place; and, beyond that, whether the monies delivered are effective.

Whether we like it or not, the Philippines experience is going to push upon us a whole series of questions, and I think those questions provide really a magnificent opportunity, if we are willing to take advantage of the opportunity—whether we like it or not the media is going to have a series of questions relative to President Marcos and what he did and did not do with money that flowed from the United States taxpayer coffer in the form of various kinds of assistance.

We may not want to have pursued the question whether tens of millions or hundreds of millions or billions of dollars have been ripped off, but questions are going to be raised, and there will be a kind of probing that goes way beyond the past.

Having said that, Mr. Chairman, I think it provides a great opportunity for this subcommittee. I don't think Peter is an international banker, and I don't think he is basically an investor, because he is concerned about people and getting response in terms of peoples' health care, et cetera.

But I wonder if we should extend ourselves beyond surface studies and use our subcommittee to use the Philippines as an opportunity to measure what has happened with our aid funds and our multilateral flows to that country as a format for evaluating what might be helping elsewhere.

I am not confident the money that has flowed for the villages of India has ever gotten to the villages. I am not confident the money we gave in emergency form to Ethiopia, all of it got to hungry people.

I wonder if we shouldn't call upon GAO or whatever appropriate agency we should point to to give us a detailed analysis using the Philippines as a basic format for what happens to our dollars.

### GAO STUDY ON FOREIGN ASSISTANCE FUNDS

Mr. **Obey**. Jerry, if I can interrupt, the first thing I did when I became Chairman last year was to talk to committee staff and instruct them to sit down with GAO and prepare and ask for GAO to develop a comprehensive study trying to determine for the most recent fiscal year for which it was possible—to try to determine where money in that aid bill acutally went. I mean, what was the chain of dollars; who were the contractors who got the money; who were the suppliers that got the money. In other words, an economic impact statement in some detail.

That is a long-range study, and it took them quite a bit of time. But that is the very first thing I asked the committee staff to undertake when I became Chairman a year ago.

Mr. **Lewis**. I certainly applaud that sort of interest and direction. There is not any question of the times our government here reacts when an issue is hot and then kind of disappears. A lot of people—as President Marcos has come to our country, in hopes that he will kind of disappear as this transition goes forward. But it is not going to disappear. There are going to be people calling for all kinds of things.

We have got to use this opportunity when the griddle is hot to highlight the reality that if one government or set of officials is able to one way or another use infungible dollars to rip off sizeable numbers of them for their own purposes, and their allies, their friends, others can as well.

I think we ought to use this time to highlight our interest and concern about this with the bottom line being our concern that the money we deliver gets to people who need and deserve and ought to have our assistance.

There are charges, for example, that one of the Generals took kickbacks from a California contractor. If somebody is delivering zero percent loans for 50 years, for some years—it seems to me there is some potential for arrangements that might not meet our hopes for adequate standards. That sort of evaluation—maybe we ought to be talking about 1 percent off the top of all these programs to measure whether they get there and whether or not some abuse is involved.

I am not looking for a response, Peter, but I would hope that you would reemphasize or re-express your interest in those concerns within your own agency.

Mr. **McPherson**. I think this line of thinking can be a very constructive line of thinking. I believe that one of the things we probably will do for major activities is to set up reasonable quantifiable goals.

One of the attractions to the child survival efforts, which is a little bit more difficult to measure than agricultural production efforts, is that you can talk about quantifiable goals. And while it is difficult, the provision of family planning services is yet another place we have had in place quantifiable goals, such as the amount of people for when services were available.

Now, ultimately what the American people want is for their dollars to provide what they are supposed to. And I think that is a test that a public agency ought to have to stand up to.

Mr. LEWIS. Peter, I must say, in response to Mr. Dixon's questioning you said by and large our money went for what it was supposed to, the Philippines.

I believe—and this is highlighted because of this unusual opportunity—that you are going to be surprised that the sources of information that told you that are probably wrong. We will discuss it later. And I do intend to keep the quote just so we can discuss it. But I think we are going to be finding out—we are going to be told some things we don't want to hear about what actually happened to those funds, what we hoped were human interest types of delivery systems over there that may not be so much human interest as we define it.

Anyway, Mr. Chairman, further, the committee's investigations staff might well be able to use this Philippines circumstance to stimulate GAO, specialize in a specific way, accelerating your request. I think it is an appropriate one.

Mr. OBEY. We work with both of the staffs, Jerry, and I have no complaint about the speed with which the GAO is proceeding. We should have the first draft reasonably soon, and I will see if it needs to be——

Mr. LEWIS. I am pleased that it is going forward.

Mr. MCPHERSON. It might interest the committee that in the late Seventies AID strengthened its evaluation unit. In the last five years, we have put in substantial additional resources and personnel to look at issues: the auditing question, which involves the Inspector General and the GAO-type questions; and the evaluation questions.

Just because the money was spent in exactly the way you thought it was spent doesn't mean it achieved the results you intended to achieve. So, as far as I am concerned, we continue to struggle on the question of quantifiable measurement of the goal you seek, not just an accounting trail.

### A.I.D. FUNDING OF FREEWAY IN GUATEMALA

Mr. LEWIS. As you were talking about transportation systems earlier, I was recalling my taking a close look at a freeway that was designed to provide improved transportation in Guatemala City. When I was there about three years ago—between what happened with the money delivery and political changes, it is just sitting there. It is not because of environmental concerns; it is because of other appropriate concerns. I am not sure it is AID money there.

Mr. MCPHERSON. I don't think so.

Mr. LEWIS. A project delivered in no small part by us that didn't get very far.

One other area of questions that relates to the Philippines opportunity, Mr. Chairman. It seems to me that it must be clear to us our interests in the world are best promoted by our development policies that help to extend democratic processes and freedom and economic opportunity. Clearly, we need to ask questions about where have we been in promoting democratic opportunities and freedom in countries like the Philippines. Where have we been since martial law was declared almost 15 years ago? Why are we asking the questions now?

This is not a single administration question. We ought to be pursuing intensely the value of our policies being linked to the expansion of freedom and opportunity rather than supporting autocratic systems, whether they are right or left, and those questions can go on and on.

We have a great opportunity to highlight the significance of the answers we get at this moment.

Mr. **Obey**. The gentleman's time has expired.

Mr. Mrazek.

Mr. **Mrazek**. Thank you.

### A.I.D. ASSISTANCE TO CHILE

Mr. McPherson, like Secretary Shultz, I can only imagine how excited and stimulated you must be on those mornings you wake up and know you are going to have an opportunity to come up here and be enlightened by those of us on the Hill.

I am curious. My first question would relate to whether we, in fact, have any new direct assistance or if your agency supporting any multilateral assistance on a loan program to Chile.

Mr. **McPherson**. The only bilateral program we have in Chile is a feeding program, under Section 416 surplus dairy. That program, involves CCC stocks and I think it is largely milk. We pay for part of the transportation, and they pay for the rest of it.

I don't believe there is any other bilateral program there. If there is, it is a very, very small one indeed.

Now, the banks, the IDB and the World Bank have programs in that area. There have been ongoing questions as to what the U.S. position should be with regard to assistance to Chile. I am not current on that enough to respond.

Mr. **Mrazek**. So, you haven't been asked to express the support of AID for any loan program that would assist the so-called emerging democracy in Chile?

Mr. **McPherson**. Well, bilaterally we have not had a program in Chile. The per capita income is reasonably high.

### A.I.D. SUPPORT TO CHILE THROUGH MULTILATERAL BANKS

Mr. **Mrazek**. That wasn't my question. The question related to whether your agency is supporting any loan programs through one of the banks which would be a supportable program in Chile.

Mr. **McPherson**. I know my staff has been in meetings in which these items have been discussed, and these meetings have been occurring over a period of time—and I think quite recently, as a matter of fact. But I don't have any personal information on that matter.

I think it is an issue that is bubbling, frankly.

Mr. **Mrazek**. Really? Is a member of your staff who has been participating in that bubbling issue here with you today?

Mr. McPHERSON. I don't think so. We will be happy to get back to you on that matter.

But the important point here, Congressman, is that it is the Treasury and State Department that has the lead responsibility on bank votes, particularly those that are political in nature, as opposed to developmental issues which we are involved in. So I am just not the person to respond.

[The information follows:]

### MULTILATERAL ASSISTANCE TO CHILE

Voting decisions on all multilateral loans, including those proposed for Chile, are made on a case-by-case basis. In the decision-making process the Administration takes into account all relevant factors, including economic, environmental and human rights criteria. A.I.D. contributes to, but does not necessarily set Administration policy on these issues, which are decided in an inter-agency context.

AID participates in the special inter-agency review mechanism that exists to ensure that human rights considerations receive particular attention during the decision-making process. An interagency working group on human rights and foreign assistance, co-chaired by the Human Rights and Humanitarian Affairs Bureau and the Economic and Business Affairs Bureau of the State Department, meets regularly to review all upcoming loans in the international financial institutions. To consider economic, environmental and developmental factors, the Treasury Department chairs, a comparable inter-agency working group on multilateral assistance. As multilateral projects for Chile come up, all of these factors will be considered.

The Executive Branch takes seriously the requirement to consult with Congress to inform it regarding prospective changes in policy direction towards countries which have or recently have had poor human rights records, and it is the intention of the Executive to continue to consult with the Congress on such matters.

### ESF DISBURSEMENTS TO COSTA RICA

Mr. MRAZEK. AID has reportedly withheld $50 million in economic support funds from Costa Rica. Can you enlighten me as to the reason for that, if the money is still being withheld, or has it been disbursed?

Mr. McPHERSON. We still have some money to disburse this fiscal year. The exact amount, I don't recall. But we have, over the past several years, in Costa Rica and other countries, disbursed the money in connection with economic policy reforms that those countries have made.

There are some deficit questions as well as some other economic policies that——

Mr. MRAZEK. I am less concerned about economic policy questions than perhaps political policy questions.

Mr. McPHERSON. Money is not being withheld at this hour in connection with political issues. I personally have dealt with the Costa Rica Government. We are going back and forth talking about some of these issues. And at least as far as AID is concerned, those are the issues before us.

Mr. MRAZEK. So no one in the State Department has suggested to you or discussed with you the concept that money should be withheld from Costa Rica?

Mr. McPHERSON. They have not.

Mr. MRAZEK. For any reason?

Mr. McPHERSON. Well, only for the economic policy reasons such as we have had over the years.

Mr. MRAZEK. Nothing recently?

Mr. McPherson. No. Nobody has discussed that with me, nor have I heard of anyone else discussing that.

Now we have, as I say, over the years been quite effective in making——

### A.I.D. FUNDING OF NATURAL FAMILY PLANNING

Mr. Mrazek. I appreciate that.

I know what a fine line we have to walk on the question of family planning issues.

Mr. McPherson. It is a pleasure and a test to come up here and testify on that issue.

Mr. Mrazek. Has AID abandoned its policy of funding family programs based upon advocacy of chastity or abstinence?

Mr. McPherson. We support natural family planning. We did last year and we will this year, probably in the amount of about $5 million.

Georgetown University is the prime contractor, and will receive about $3.5 million of that $5 million.

### INFORMED CONSENT PROVISION

Mr. Mrazek. As I understand it, there was a program being funded which violated the informed consent provision of the policy guidelines in regard to the alternative methods of family planning that might be available to people. Does that program continue to be funded?

Mr. McPherson. You are speaking of the "Families of America Foundation" program—we have funded an organization called "Families of America Foundation" I believe is the name. Mercedes Wilson is the leader of that organization. That program did not involve the delivery of services, but rather involved the preparation of materials and training people.

That program will not, as I now see it, receive any money this year. It had money left over from the program funded last year. Congress has taken a position and I have been sworn to uphold the laws of the United States, and given me a directive on the question of how we would handle a number of issues involving AID funding of population programs.

Mr. Mrazek. In any event, it would be the policy of AID not to fund any program which violated the informed consent policy guidelines?

Mr. McPherson. That is true.

### AID ASSISTANCE TO NORTHERN IRELAND

Mr. Mrazek. Forgive me for skipping around, I have a question on the AID package that is being drafted for Northern Ireland. Have you participated in that?

Mr. McPherson. Yes, I have. It is my hope the committee will support that package, which I believe came through here last night, and which combines $20 million in ESF with other programs and guarantees.

Mr. Mrazek. How would those monies be disbursed in Northern Ireland?

Mr. McPHERSON. The details aren't all worked out, but one assumes that the $20 million ESF portion would go through the Fund which hasn't yet been organized. It is difficult to explain the exact relationship between the ESF funds and the other programs.

Mr. MRAZEK. What does that mean?

Mr. McPHERSON. Well, it means that we would put monies into activities in Ireland which the Fund would find acceptable. We wouldn't do it independently of the Fund's desires or actions.

Mr. MRAZEK. And those decisions would be made by whom? Would they be made by you on behalf of the fund?

Mr. McPHERSON. The parallel programs are all bilateral activities, with the exception of some OPIC guarantees. I am Chairman of the Board of OPIC.

Mr. MRAZEK. Is there any thinking about the concept of providing the types of incentives for American entrepreneurs to perhaps invest in those areas of high unemployment with guaranteed job training programs and productive private sector job areas, as well as the kind of insurance from OPIC that would allow them to go forward with the knowledge that they wouldn't be wiped out by a terrorist act?

Mr. McPHERSON. Well, there certainly is, and we think that jobs are an important part of the future in Northern Ireland. Part of the $50 million program would be run through the Trade Development Program. It has conducted successful feasibility studies for U.S. investment, and I see OPIC, the insuring organization, as having a role as well.

As far as I am concerned, jobs which create an environment to stimulate investment growth are a key part of it. It seems to me that the economic depression is one of the many swords in Northern Ireland.

Mr. MRAZEK. Let me just express to you my concern that if a mechanism is developed which relies on the British Government to assist you in determining where the money ought to be spent, there is obviously a keen mutual distrust between all of the various parties involved in the Northern Ireland community. It would seem to me one of the ways we might be able to avoid some of the problems associated with that is by relying on American entrepreneurs who would be willing to make a financial commitment themselves, based upon again both tax incentives, as well as the types of on-the-job training programs which they would be reimbursed for, but where there would be guarantees for productive private sector jobs, particularly in those areas of highest unemployment in Northern Ireland, which just coincidentally happen to be the Catholic areas, of course. You have 50 percent unemployment in certain parts of Northern Ireland. I would hope those are the areas that are going to be targeted for a good deal of the assistance.

Mr. McPHERSON. I agree with that.

Mr. MRAZEK. Thank you very much.

Mr. OBEY. The gentleman's time has expired. The chair recognizes Mr. Porter. Mr. McHugh has a quick request.

## REQUEST TO SUBMIT TABLES AND QUESTIONS FOR THE RECORD

Mr. McHUGH. Thank you, Mr. Chairman.

I just want to ask unanimous consent if I could include in the hearing record two tables I referred to in my earlier discussion with Mr. McPherson, one relating to comparisons between bilateral aid in Central America and Sub-Saharan Africa; and, secondly, a table on ecnomic growth rates in Central America, and, finally, Mr. Chairman, unanimous consent to submit to the Administrator questions which I did not have time to ask.

Mr. OBEY. Sure.

[The information follows:]

## TABLE I

## U.S. ECONOMIC ASSISTANCE TO CENTRAL AMERICA AND SUB-SAHARAN AFRICA FISCAL YEAR 1986 COMPARED TO FISCAL YEAR 1981*

| FISCAL YEAR | CENTRAL AMERICA | SUB-SAHARAN AFRICA |
|---|---|---|
| 1981 Actual | $231,721,000 | $649,427,000 |
| Development Aid | $99,224,000 | $300,295,000 |
| Peace Corps | $7,123,000 | $38,761,000 |
| Economic Support Fund | $102,374,000 | $162,971,000 |
| P.L. 480 Title I | $23,000,000 | $147,400,000 |
| 1986 Estimate | $821,029,000 | $823,766,000 |
| Development Aid | $243,044,000 | $336,781,000 |
| Peace Corps | $13,926,000 | $46,183,000 |
| Economic Support Fund | $466,059,000 | $288,702,000 |
| P.L. 480 Title I | $98,000,000 | $152,100,000 |

*) Data Source: Agency for International Development Congressional Presentation Documents. Development assistance for Africa includes Sahel Development Program. ESF assistance for Africa includes funding for the Economic Policy Initiative for Africa. Funding for Nicaragua is included in the fiscal year 1981 base for Central America although no funding will be provided to Nicaragua in fiscal year 1986. Please note that P.L. 480 Title I is included, and P.L. 480 Title II is excluded, from this table at the specific request of the Agency for International Development although neither is funded in the foreign aid appropriations bill.

### TABLE II

### U.S. ECONOMIC ASSISTANCE TO CENTRAL AMERICA AND SUB-SAHARAN AFRICA FISCAL YEAR 1986 COMPARED TO FISCAL YEAR 1981 % INCREASE IN NOMINAL AND REAL TERMS*

| PROGRAM | CENTRAL AMERICA | | SUB-SAHARAN AFRICA | |
|---|---|---|---|---|
| | Nominal | Real | Nominal | Real |
| Development Aid | 144.9% | 96.9% | 12.1% | -9.8% |
| Peace Corps | 95.5% | 57.2% | 19.1% | -4.2% |
| Economic Support Fund | 355.3% | 266.0% | 77.1% | 42.4% |
| P.L. 480 Title I | 326.1% | 242.6% | 3.2% | -17.0% |
| Total | 254.3% | 184.9% | 26.8% | 2.0% |

*) Calculations of positive and negative real growth are derived from conversion tables provided in the Security Assistance Congressional Presentation Document for FY1987.

Mr. McPHERSON. Would the Congressman be able to asterisk the African table to include the nondisaster portion of Public Law 480?

Mr. McHUGH. By all means.

### A.I.D. FUNDING OF UNFPA

Mr. PORTER. Thank you, Mr. Chairman.

Peter, let me mention what a fine job you do in general, and your fine written statement that I had a chance to look at. While I don't agree with all of the AID policies to family planning, obviously the statement that you put into the record is a very fine one, particularly the emphasis on voluntary family planning as an alternative to abortion. I think it is exactly where we ought to have our philosophy on population.

I wonder if you would comment upon what is happening with UNFPA in China. I notice you have $32 million earmarked in the budget for UNFPA. Under the conditions of the Kemp-Inouye language, what is happening with UNFPA, and what do you see as the possibilities of UNFPA actually getting those funds?

Mr. McPHERSON. This year we don't have it earmarked in a technical sense. This year we have set aside $30 million for UNFPA. UNFPA is an organization which we do not wish to harm, but which we think, pursuant to law, must change certain policies if they are going to receive our money.

As you know, as of this hour, I have no information that UNFPA's program is different than it was last year as it currently is operating. You remember last year we concluded that UNFPA participated in the management of the Chinese program. Secondly, we do not have information which suggests a material change in the Chinese program, Under the statute you would have to have one of those two things changing before we could provide funding.

I have indicated in the past that at the time we decided to hold back the last $10 million last year that the U.S. Government could, we didn't say "would", we said "could", provide UNFPA money under that statute if UNFPA's programs in China were dramatically different—providing contraceptives, for instance.

Mr. PORTER. If they provided $10 million worth of contraceptives instead of $10 million worth of computer technology, that would meet the standards?

Mr. McPHERSON. If they did that, if they provided only contraceptives, then under the statute I believe we could legally provide UNFPA money. We have not had to make a decision on the matter.

### FUNDING FOR NGO'S WHO SUPPORT ABORTION

Mr. PORTER. Can you also trace for the subcommittee what has happened with regard to the cutoff of funding for NGO's, who, with their own funds, are providing abortion or abortion-related services, such as IPPF? What has happened recently, and have organizations acceded to this language largely or not?

Mr. McPHERSON. They have largely acceded. IPPF was the marked exception.

Mr. PORTER. Also the largest provider.

Mr. McPherson. Yes, the largest nongovernment provider, that is correct.

Now, we are currently being sued by an organization, DKE, an organization alleging that we would not fund them. Frankly, we don't understand when this all took place. Also there was a subcontractor, I believe, in Brazil, a subcontractor for Path-Finder, an organization called SOS, that isn't receiving money. I guess there are a few other cases.

But it is overwhelmingly true that the policy has been accepted, and we are implementing, I think, a reasonably strong family planning program.

### WORLD BANK POPULATION LOAN TO BANGLADESH

Mr. Porter. Recently, and I know this isn't in your direct area, but our Executive Director of the World Bank apparently was instructed to vote against a new family planning loan to Bangladesh where the problems of inordinate population growth and the implications for their economy are among the worst in the world. Do you know why he was so instructed, what reasoning process brought that about?

Mr. McPherson. Yes. This was in large part a population project, and that is an important point.

Mr. Porter. What does that mean?

Mr. McPherson. That means it was to provide family planning service. Of course, the health program is in large part a family planning project. That project involved the building of clinics—clinics in which it was expected that abortions were going to be performed.

Mr. Porter. It was only expected or suspected?

Mr. McPherson. Expected. It wasn't just a possibility, it was thought to be, expected.

### UNAUTHORIZED SALE OF U.S. MILK IN SOUTH AFRICA

Mr. Porter. Recently in the Johannesburg Star there was a report 6,000 bags of milk powder marked with a statement "Given by the people of the United States—not for sale" were being sold in South Africa. I didn't know that we had a Public Law 480 program in South Africa. I certainly know we don't allow food marked in this way to be sold. Have you seen these reports, and do you have any comments for us?

Mr. McPherson. I did indeed. Originally it was reported that there was a very large amount of food that was involved. Every bag of food that we have is numbered, so we are able to track them. It seems that there are 123 tons of food that currently cannot be tracked out of a Botswana program that the World Food Program runs. In other words, what is involved here is U.S. food run through the World Food Program. What I have done on this was ask the South African Government, and other investigative authorities, to inspect it. We don't have the report yet, but I think that that was the appropriate action, and I feel reasonably confident we will find out what happened.

Mr. Porter. Diverted means probably stolen?

Mr. McPherson. Yes, sir. Exactly. I don't mean to mince words. This is 123 tons we are speaking of, and we have gone to the right authorities and said "Let's get it straight."

Mr. Porter. Does this happen often in the P.L. 480 program?

Mr. McPherson. Last year, in Africa alone, we provided three million tons, so 123 tons is a small amount of the total, but, of course, it is a fair amount. It is an amount to be worried about. We are able to track things reasonably well because of our bag numbering system.

Mr. Porter. But you didn't know about this one unless it was reported in the South African paper?

Mr. McPherson. That is correct, we did not, and I don't know if the World Food Program did. We provide a substantial amount of food which they manage every year. Whether the people in Rome knew about it or not I don't know, but I know that when we heard of it, we took the two actions I just attested to.

Mr. Porter. You may have answered this already, if you have, I don't want to keep you, just to tell me—

Mr. McPherson. My feeling is we have a relatively small amount of diversion of food worldwide.

## FUTURE SUPPORT FOR THE PHILIPPINES

Mr. Porter. If you have answered this, don't answer it again because the hour is late, what do you see in terms of our support for the Philippines in the next few years? Obviously things have changed greatly since the budget was prepared.

Mr. McPherson. We just don't know. We are looking at that situation now and will do so intensely in the weeks ahead. I don't have an answer at this time.

Mr. Porter. We hear $800 million is likely to be a proposal. Have you heard that figure?

Mr. McPherson. I was quoted as saying that—it surprised me—I read it in the morning paper.

Mr. Porter. I didn't hear what you said.

Mr. McPherson. I sat up straight in the morning when I read that I said that. What was quoted was a recitation of the various amounts which are in the pipeline or which we have not yet obligated for fiscal year 1986. There is also the possibility that the World Bank, the ADB and others may get involved. But we are not saying that there are "X" amounts of dollars that we will give or that other people will give. That is a misimpression, because we have not yet sorted this through.

There is a new cabinet in place and a new financial minister in Manila, of course, so we are working hard on these various questions.

Mr. Porter. Thank you very much.

Mr. Obey. Mr. McPherson, I have about 30 questions, or so, some of which I will put into the record, so we can get some basic information we need before we mark up. There are a few of them, however, I want to run down very quickly with you. I would appreciate very short answers or we will be here from now until breakfast.

Mr. McPherson. Yes, sir.

### A.I.D. PIPELINE

Mr. **Obey**. First of all, I would simply ask you, we are going to be asking both you and Mr. Schneider to give us a description, if you haven't already done so, of the latest information you have had in terms of what funds you have available, pipeline funds, which are unobligated, because in this bill we need to know——

Mr. **McPherson**. We look forward to that.

### A.I.D.'S ENVIRONMENTAL PROGRAMS

Mr. **Obey**. Secondly, let me pursue some questions with you on your role in dealing with world environmental problems, which may snap back on us very badly as in the case of Africa, Ethiopia, et cetera. As I look through your budget, I, personally, have a difficult time ascertaining exactly what kind of tracking system is available so that I might have a good idea of what you are doing to assure that projects which are being developed, while they might be economically useful for the short term, don't cause a lot of problems in the long term in terms of the environment. The whole Central and Regional Office Environmental Program up here fluctuates differently from year to year, and it makes it hard for me to determine exactly what is going on.

Let me ask you, the Bureau of Science and Technology, we think if you were to use personnel to focus on long-term environmental problems associated with developing projects, for instance, that that might be one place where you would have a special reliance on personnel to give you that information. Is that correct or not?

Mr. **McPherson**. Well, we have in the past. I have reorganized this so that the new man coming on as our senior environmental person in the Agency will report directly to my office. We really have an excellent record here.

### STAFFING OF ENVIRONMENTAL PROGRAMS

Mr. **Obey**. Isn't that staff being cut back a considerable amount?

Mr. **McPherson**. We have this one person I mentioned who is a an A.I.D. Mission Director, and he will draw upon people throughout the agency. What you really need are individual environmental studies that are appropriately done in connection with those individual projects. I don't see this as something which is separate from the mainstream. If you have a project in the Andes, you should have a project study done in connection with the Latin American Bureau or Peruvian Mission. And just being sure it is aggressively done, is what I think is required.

Mr. **Obey**. What I would be curious to know is how many people you have whose responsibility is to solely focus on questions of environmental impact.

Mr. **McPherson**. Let me provide you with the number. The number, 100 percent dedicated to environmental issues, is a very small number indeed because of the way I have the structure organized. My impression is that the environmental community thinks we have really been a leader in terms of pursuing these issues.

Mr. **Obey**. I am sure they appreciate what they are getting, but my conversation with them indicates they have had a problem with

AID for a long time, long before you came on board, and that they still are concerned about allocation of resources. Do you have any idea how many full-time—what I would like for the record is how many full-time dedicated staff people there are this year versus last year in the Central and Regional offices.

Mr. McPherson. Let us get that to you.

[The information follows:]

DIRECT-HIRE ENVIRONMENTAL STAFF IN AID/WASHINGTON IN 1985 AND 1986

| | 1985 | 1986 |
|---|---|---|
| Regional bureaus: | | |
| Africa (AFR) | 1.0 | 1.0 |
| Asia and Near East [1] (ANE): | | |
| (ASIA) | 1.0 | 2.0 |
| (NE) | 2.0 | |
| Latin America and Caribbean (LAC) | 2.0 | [2] 1.5 |
| Central bureaus: | | |
| External Affairs (XA) | 1.0 | |
| Office of the Administrator (C/AID) | | [3] 1.0 |
| Science and Technology (S&T) | 3.8 | 3.6 |
| Program and Policy Coordination (PPC) | .5 | .5 |
| Total | 11.3 | 9.6 |

[1] Asia and Near East Bureaus were combined in late 1985.

[2] Energy responsibilities were added to environmental staff duties.

[3] Agency Environmental Coordinator transferred from XA to C/AID; new appointee to begin work in June 1986.

Mr. Obey. There are other questions I will insert in the record.

### WARNING SYSTEM FOR PROJECTS ADVERSELY IMPACTING THE ENVIRONMENT

Let me ask you this, I understand the Treasury Department is talking about establishing an early warning system under which AID field missions would be used to alert state and Treasury of potentially environmentally disastrous MDB or AID projects in advance. Can you give me some idea of how long that is and how that is expected to work?

Mr. McPherson. Yes. I am intrigued with that concept. We have been urging the banks, the World Bank particularly, and others, for some time, to do essentially what AID does in terms of environmental concerns on their projects. Moreover, we have had an early warning system on bank projects which permits a mission in Botswana to feed back to Treasury a concern that they might have on a health project, education project, et cetera.

So this would be an expansion of that theme. We have to work through how it might work and the operating expense concerns about it, which I continue to struggle with daily. It intrigues me because I think we are, after all, the number one development agency of the Government, and to the extent we can help in that regard, we ought to be doing so.

Mr. Obey. A number of years ago, when I first came on the subcommittee, I was sitting where Bob Mrazek sits now, I was involved in questions of the chemicals and pesticides which we don't allow use of, or allow use of under strict circumstances in this country to be used abroad and peddled abroad, not because—well, never mind.

Mr. LEWIS. It is called applied research.

## DISTRIBUTION OF PESTICIDES

Mr. OBEY. It is called trying to protect people abroad from the same things we are trying to protect them from here at home.

I recall, for instance, we had a nasty problem with a pesticide in Pakistan in 1977. My impression is that AID had been doing a pretty good job lately on this issue. You reached a settlement with environmental groups on a lawsuit concerning the indiscriminate use of pesticides, and my understanding is that settlement was the CIP program would not, except in rare instances, be used to distribute pesticides.

Mr. MCPHERSON. I have to approve every time we do so.

Mr. OBEY. Pesticides would only be used through project assistance with more direct controls. Now, the Sierra Club, with the National Defense Council, Environmental Defense Fund, and Audubon Society, in a January 22nd letter, expressed concern you are relaxing the prohibition on the use of pesticides in the CIP program, making major changes in that settlement. Would you care to comment and tell me what that situation is?

Mr. MCPHERSON. I haven't made decisions on that point. I am aware that some groups have argued that this issue is being reopened, and I plan to personally get into it. Since I am the person who, under that former agreement, had decided when CIP monies could be used for pesticides, it is clear I am going to get back into this again. I think that we need to be concerned about environmental considerations.

At the same time, I think we ought to make sure, at least in some circumstances, that we can use pesticides. I remember how critical the pesticides were for a cotton crop in Sudan a couple of years ago.

Mr. OBEY. I understand they are critical. The problem is you have a population which has very little understanding of the dangers some of these products can cause if they can't read labels, if they don't know—if they don't have the kind of public health information available in most countries, you will have a lot of latency problems develop, not to mention a lot of immediate toxicity problems develop, and I am very, very aware of any changes that will lead us to—

Mr. MCPHERSON. Why don't we keep you informed about these? I say that, in that fashion, because I have only recently become aware that this was a matter of discussion, and my staff first mentioned to me that there was some additional interest in it only two days ago.

Mr. OBEY. I was told in fiscal year 1984 more than $100 million of fertilizer and synthetic compounds were purchased under CIP without any real guidelines.

Mr. MCPHERSON. Fertilizers have been purchased under CIPs for some time. I guess I don't view those as pesticides—insecticides which pose the same kind of questions do arise. I realize they occasionally can, but I think they are really quite different than what we bought for Bolivia some years ago.

Mr. OBEY. Do we know whether any of those substances are banned from the U.S?

Mr. MCPHERSON. I don't think any of those were. The fertilizers surely were not.

Mr. OBEY. I have a number of questions on this subject I would like to insert.

### A.I.D. IMMUNIZATION PROGRAM

The AID immunization program, we had some discussions on that earlier. In fiscal year 1986, we appropriated $25 million to begin toward the Congressional goal of immunizing 80 percent of the kids in AID-assisted countries by 1990. My understanding is that CDC is supposed to serve as your main technical resource. Is that correct?

Mr. MCPHERSON. We have major resources—in fact, the man heading my program internally just came from CDC a year ago.

Mr. OBEY. For the record, what is your best professional judgment as to the total dollars that will be needed to accomplish that goal laid out by the Congress?

Mr. MCPHERSON. We will provide that.

[The information follows:]

### COST OF IMMUNIZING 80 PERCENT OF CHILDREN IN A.I.D.-ASSISTED COUNTRIES BY 1990

Current immunization coverage rates for the vaccine-preventable childhood diseases range from zero to almost 100 percent. Coverage rates tend to be highest in Latin America and lowest in Africa, highest for TB and lowest for measles and neonatal tetanus. Therefore, the costs of reaching 80 percent coverage will vary tremendously depending on the country.

Looking at A.I.D.-assisted countries in the aggregate, however, we calculate that it would cost roughly $2.3 billion over the next five years to reach 80 percent of children under five in A.I.D.-assisted countries with the six EPI vaccines [measles, polio, DPT, BCG]. An additional $700 million would be required to reach similar levels of protection against neonatal tetanus over a five year period. Thus, the total cost of achieving the Congressional goals by 1990 is roughly $3 billion.

Clearly, the recurrent cost implications of these efforts are daunting, and LDC governments must be encouraged to increase their budgetary contributions to immunization programs. Costs, however, are not the only impediment to achieving 80 percent coverage. Countries require trained staff, a supportive infrastructure (transportation and facilities), and a communications network to realize rapid improvements in immunization coverage. It is for this reason that our strategy is to concentrate A.I.D.'s child survival efforts over the next 3-5 years on approximately twenty countries where both the need and opportunities for meaningful progress are the greatest.

Mr. OBEY. Any idea, roughly?

Mr. MCPHERSON. I think that it would be easier, if you wouldn't mind, for us to take selected countries, like India, which is probably the country with the highest child mortality rate which can be reduced as a result of immunization. I would like to take some selective countries and see if we can do that.

Mr. OBEY. The reason, frankly, I would like for you to respond to that here as much as you can, because my experience has been when I ask a witness what his professional judgment is, if he is able to answer that question directly here, it is easier for him to shoot straight from the shoulder than it is when he offers it in written form.

Mr. **McPherson**. Let me answer it directly. As regards India, I think it will take about $20 million a year, of outside resources to—let's see, numbers I have heard is, I think, $20 million total for a period of like five years to really put the program firmly in place, and we are providing $6 million this year to that country.

As regards the Congressional goal of immunizing 80 percent of the kids in AID-assisted countries by 1990, it will take about $458 million a year more than what is currently being spent on immunizations in each country to reach 80% of all the children under the age of of one.

There is a qualification here that is important. The problem with immunization is that you need a cold chain. If the vaccines aren't maintained below a certain temperature over a period of time, they no longer work. When you try delivering immunizations to nomads in Chad, you are in trouble. You are better off with ORT, which is easier to get out. So in trying to follow international standards and get the job done, you can run into some real difficulties.

Mr. **Obey**. I understand. Congress has laid out its goal and it is my job, as an instrument of Congress in this instance, to focus on it.

It is awfully important to have an adequate pool of well-trained health care professionals available if we are going to meet the mandate the Congress has talked about.

Mr. **McPherson**. I believe so. In fact, I wanted to respond to your comments earlier about that.

Mr. **Obey**. My question in that regard is this: Have you been able to get a sufficient number of trained staff to insure that we will be able to reach that mandated goal in the timeframe being discussed by the Congress?

Mr. **McPherson**. It has been a struggle. Clearly we have strengthened this area, and we are doing some exciting things and getting some good people. One of the ways to meet this goal, however, is to get good contract staff. For example, in Ecuador, where we have a major immunization and ORT drive underway, we have hired a person on contract to manage that program.

Mr. **Obey**. How short are you in terms of personnel from whatever source that you would get them——

Mr. **McPherson**. It is a matter of dispute. Some health people would say we are really quite short, that we need a couple dozen or so; others would say "Wait a minute, we can do this by way of this or that contract"——

Mr. **Obey**. Forget whether it is done by contract or whether Mickey Mouse does it. My question is how many people are you going to need to do the job on the schedule laid out by the Congress, without arguing about whether the health people are right or somebody else is right? I don't care what either of them think, I just want to know what the number is.

Mr. **McPherson**. It is my judgment we will be able to recruit significantly more people and put them in place by the end of this year and I think over the next few years, our health staff will build up significantly.

Mr. **Obey**. That is not my question. My question is how many people do you need now in order to get the job done?

Mr. McPherson. I would have to put some considered judgment in order to give you that number—more people than what I have now. I do have a whole task force on child survival, with a senior person in charge.

Mr. Obey. That is not where I am headed. I just want the numbers. If you have to worry about it—just answer my question. If you think of it when I talk about it later down the line, tell me. I don't have time to dance with this now, I have got to get some stuff in the record. I have two other questions on privatization I would like you to answer at this point and two on AID audits and evaluation reports and two on housing.

[The information follows:]

### Health Staff

The Agency is in the final stages of an internal staffing exercise reviewing the adequacy of our staff to manage our child survival initiatives. In general, we are reaching the conclusion that most field missions are reasonably well staffed.

Currently, we have 82 professional Agency field officers managing health programs in 38 countries. In addition, we make use of contract personnel to supplement our staff. For example, we have an agreement with the Centers for Disease Control that supplies 22 health experts in Africa, most of them on immunization programs. We also supplement our direct-hire field staff with foreign service nationals, personal service contractors and institutional contractors.

There are a few problems, of course. A couple of countries that are going to receive special emphasis over the next five years, are short staff in health. There are also some shortfalls in Washington staffing. However, we are taking the steps to remedy those problems within the limitations that confront us, and I fully expect that we can meet our child survival goals with only a modest increase in direct-hire technical staff.

### AFRICA DISASTER ASSISTANCE

Mr. Obey. Let me move to African disaster assistance. Last year the administration asked for $25 million in migration and refugee assistance in Africa. Congress, as you know, believes the need was somewhat greater and provided somewhat more funding than the administration asked for. We made those funds available through March 31 of 1986.

Can you tell us, of the $175 million we provided, how much of that money you expect to have expended by March 31st, including the funds AID has borrowed from developing accounts?

Mr. McPherson. All of the $175 million of disaster assistance funds will be obligated. The amount which will be disbursed I don't have with me, but disbursements will continue throughout the year. All of the funds will be obligated, however, by the March 31 expiration date. I am tracking that regularly.

Mr. Obey. I have got other questions I will insert at this point and then ask: Do you think that we are going to need more this year?

[The information follows:]

### African Disaster Assistance

Mr. Obey. Mr. McPherson, last year the Administration requested $25 million in disaster assistance and $25 million in emergency immigration and refugee assistance in Africa.

The congress believed the need was much greater. We provided $175 million—$139.5 (sic should be $137.5) for disaster assistance, $25 million for the emergency migration and refugee assistance fund, and $12.5 million for the regular migration and refugee assistance account. We also made these funds available through March 31, 1986.

Mr. McPherson, will you tell us how much of this money AID has spent or expects to have spent by March 31 including the funds from the emergency account for this purpose?

Answer. By March 31, 1986 we will have obligated $214.8 million for non PL 480 food assistance as follows:

| | *Millions* |
|---|---|
| Supplemental disaster assistance | $137.5 |
| Borrowed from DA account | 26.4 |
| OFDA account | 13.4 |
| ERMA Replenishment [1] | 25.0 |
| Refugee Assistance | 12.5 |

[1] The President's Emergency Migration and Refugee Assistance Fund (ERMA) and Refugee Assistance funds were not administered by AID. They have been included in the table above because the Supplemental included an allocation to these accounts and they are considered part of the total non-food assistance provided.

All of these funds will have been obligated by March 31, 1986 and about half have been spent. Most of the remainder will be spent during FY86 some activities will carry over into FY87.

Mr. OBEY. When do you expect to repay the development accounts the money you borrowed for this purpose? We provided so much more than you requested that we certainly expect you to repay the additional amount which you borrowed.

ANSWER. We do not anticipate repaying the development accounts for funds borrowed prior to the start of the African Famine Supplemental appropriation to meet the extraordinary needs of famine relief in Africa. These funds were made available for emergency relief purposes through use of the authority in Section 492(b) of the Foreign Assistance Act.

As we reported to Congress earlier, the severe drought and concommitant need to focus maximum resources on the food relief effort slowed implementation and disbursement within many of our regular development activities. As a result, we were able to make funds available to the famine relief effort without having any adverse impact on the regular development program.

Mr. OBEY. Can you tell us why the Administration was so incredibly far off in its request and original assessment of emergency needs in Africa?

ANSWER. The Administration originally requested $25 million for a supplemental. Our assessment of the need and a review of the total resources available to the agency that could be used to respond to the African emergency indicated that this request would be adequate. OFDA had $25 million available in the disaster assistance account that could be used for emergency relief and recovery activities in Africa and we had borrowing authority for an additional $50 million from the development assistance account that could be drawn down if the OFDA disaster assistance and supplemental were not sufficient.

In fact, the rate of obligations for non-food disaster assistance in FY 1985 have supported, we believe, those initial estimates. Though $137.5 million was available in the supplemental, only about $70 million was obligated during FY 1985 to meet the emergency situation. Thus, the planning level of $100 million ($25 supplemental, $25 disaster assistance, $50 borrowing authority) would have been sufficient.

Mr. OBEY. What have you done to improve your projections?

ANSWER. As we gain additional experience with droughts and the famines they are produced, we are able to improve both our planning capabilities and our response mechanisms. For example, our experience with the Sahel drought of 10 years ago enabled us to respond more quickly there than in Sudan where famine was a newer phenomenon and in Ethiopia where we had more experience but were confronting a much changed system of government.

We have also instituted new procedures and systems that should provide us with much more accurate and timely data for planning for future emergencies.

Though we cannot predict with 100% accuracy whether or not there will be a drought, the early warning system now in place is capable of integrating precipitation, cropping and social factors to predict famine at the earliest possible moment. As a result, we can identify the signs that famine may be occurring and respond faster, deal with the logistics problems more effectively and provide food, money and people to address the problems much earlier than before.

In Sudan, for example, we are financing an early warning system with the Ministry of Agriculture and the other donor agencies that has already helped us identify the areas that will be in greatest need of assistance this year. We were able to target our assistance to parts of those areas and to work with the other donors to assure adequate coverage for the rest of the region identified.

Through collaboration with the other donors and the host governments, we have greatly improved the food needs assessment process and estimates of food requirements are now much closer together.

Because of the early warning systems and the collaboration with other donors, we are able to schedule the shipment of commodities more efficiently and identify some of the major bottlenecks in transport and logistics that plagued the program. For example, in Ethiopia we have already shipped 90% of the food aid that we are committed to provide this year. In Sudan, we have already prepositioned over one-third of the 200,000 metric tons committed for the Western region and anticipate 80 to 85% prepositioned before the rains start in July.

Mr. Obey. What emergency needs do you expect Africa to have this year?

Answer. Africa's drought-related emergency food needs in 1985–86 are considerably over 1984–85. The United Nations and A.I.D. agree that the most seriously affected countries this year are Angola, Ethiopia, Mozambique and Sudan. In addition to the impact of drought, all four countries suffer from civil disturbances and, in three of the four, from national policies which discourage agricultural production.

A number of other countries will need some emergency food aid assistance in 1986 as they recover from the impact of the drought in 1985. Mali and Niger are included in this group.

In FY 1985, the U.S. supplied 1.8 million MT of emergency food aid, valued at $776 million, to more than 20 countries in Africa.

Thus far in FY 1986 the U.S. has supplied over 486,000 MT of emergency food aid, valued at $211.5 million, to fewer than 10 countries. It is likely total FY 1986 emergency food aid approvals will be under 600,000 MT, or only one-third last year's amount. More than half the total will be for Ethiopia. This is an accurate reflection of the dramatic reduction in the need for emergency food aid in sub-Saharan Africa this year.

Requests for non-food emergency needs are also reduced considerably. Most of programs approved so far in FY 1986 (from the supplemental) have been for logistics infrastructure (through road repair and improvement), or for recovery items such as seeds and agricultural tools, and for the purchase and transport of locally-procured surplus cereal grain. No support for airlift, for example, is contemplated at this time, although the situation—particularly in Sudan—is under continual review.

FY 1986 P.L. 480 TITLE II EMERGENCY FOOD AID PROGRAMS

| | Metric tons | Value (millions) |
|---|---|---|
| Country: | | |
| Angola | 12,240 | $4.5 |
| Cape Verde | 2,000 | 1.4 |
| Ethiopia | 227,560 | 116.0 |
| Ethiopia Refugee | 45,000 | 15.1 |
| Mali | 34,420 | 12.2 |
| Mozambique | 55,418 | 16.2 |
| Niger | 15,182 | 8.8 |
| Somalia | 32,000 | 12.3 |
| Sudan | 12,496 | 25.0 |
| Total | 486,316 | 211.5 |

Note.—Includes $15.9 million for internal transport of 1985 Title II emergency food aid.

Mr. Obey. Why is it that international organizations and the Hunger Committee always seem to believe that need is greater than AID does?

Answer. In the past there have been differences betwen our estimates and those of the international organizations, but today we are much closer together particularly in the assessment of food needs. The primary reason for this is the improved methodologies we are all using and the joint approaches we have supported in the field.

The current disagreements can, for the most part, be attributed to differences in the definitions used and the sources of funding identified. We agree that Africa is in need of assistance, particularly in those areas that were hardest hit by the emergency. Where we disagree, is how to define that assistance. We have always maintained that the development programs that we are supporting in those countries hit by the drought have, as one program goal, mitigation of the conditions that exacerbated the drought or brought about the famine. This is especially true in the Sahel and in Sudan. But some of those activities which we would include in our ongoing development program are listed by the international organizations as part of a drought recovery program.

Many times where we do disagree, it is because these organizations must respond to their members' stated needs and may not be taking into account other issues and concerns underlying the problem. We look to our policy dialogue as an approach to responding to the underlying problems which we believe must be addressed before the problem can be corrected. The international organizations frequently take a more programmatic approach.

Mr. McPHERSON. I don't think so. But I intend to keep the Congress informed if I do.

Mr. OBEY. If you don't—let me ask another question on that—if you don't think you do, and obviously we did last year need more—at least the Congress concluded we needed more than the administration's thought. To put it in a neutral way, what changes, if any, have you made in the way you make your estimates of need, in order for the Congress to feel more comfortable with your estimates this year than they did last year?

Mr. McPHERSON. The situation last year was exploded practically month-by-month and week-by-week. The dynamics of this situation this year are not nearly like that. We have been able to more sensibly use satellite information, and make more extensive use of people on the ground, the BPO system itself has been helpful in that regard. I think we have been in high gear now for 18 months, and I feel quite confident of assessments I can make today based upon the information and experience we have now compared to what we had a year ago.

### ASSISTANCE TO LIBERIA

Mr. OBEY. As you know there has been a lot of talk about the Philippines lately and with the test Wednesday in Liberia where you had a similar situation, but not quite the successful outcome we have experienced in the Philippines. The administration has requested major security assistance for Liberia, for instance, up by about 39 percent, or double that amount.

My understanding is that you are proposing a decrease in development assistance. As you know, Congress has been strongly critical with what has been happening in Liberia. The House passed a resolution on February 18th which favored a number of conditions on Liberia's economic aid and a suspension of military assistance. In light of concerns over Liberia, and I will ask Mr. Schneider to give the answer to the other half of this question, why is the administration suggesting we decrease so-called nonpolitical development assistance and increasing ESF and military assistance, and is that the right way to go if we are concerned about that government's ignoring of the results of elections?

I guess my problem is this: If we are unhappy, either we should cut off aid across the board or reduce aid across the board or else send the message we think will get the most attention. I doubt that we are going to get the most attention by increasing military assistance and decreasing economic assistance. I would like both your response and Mr. Schneider's response to that question.

Mr. McPHERSON. Aid was cut: our DA numbers were down, and we made cuts in many different places. Part of the ESF allocation I would suspect will be used for development activities. In Liberia, the dollar is the unit of currency. We have not made a decision on disbursment of the ESF moneys. There are a number of pluses and minuses, as I said earlier, that need to be looked at.

An interesting difference between Liberia and the Philippines, was that there wasn't really as much developed opposition to the Doe government as there clearly was with Mrs. Aquino. I think this underlines the need for us to continue with our training programs and to see that our bilateral assistance program is an economically oriented program and a democracy development program. We have, I think, a dual track to follow.

Mr. OBEY. I have to say, however, that given the fact the House has passed a resolution indicating that we ought to suspend military assistance, I think we have got a little problem here. I would rather we work it out institutionally rather than having an argument with the administration on this in this instance, because I don't think that we should differentiate between the Philippines and Liberia simply on the basis of whether or not there is a stronger opposition in the Philippines than Liberia, because I find it hard to believe there isn't going to be a stronger opposition to the Liberian Government tomorrow.

Mr. McPHERSON. I wasn't trying to base all the distinctions on that, I was just pointing out, that I think it is noteworthy in one country that you have a much more politically-developed system in the Philippines than you have in Liberia.

### USE OF SURPLUS FOOD

Mr. OBEY. I have a number of other questions.

Let me ask one more, and then I know Mr. Lewis has some questions. And this is a parochial question. Every time I raise it, I know people grin because they know I come from a dairy district. But the fact is that one of the toughest questions to me to answer is when somebody comes up to me and says "Although we have got all this surplus food lying around, a lot of grain, a lot of dairy, why in God's name are so many people dying, can't we get more of it to people who need it in the world?"

This subcommittee does not have jurisdiction over Public Law 480 programs, but nonetheless I have been asked—I have asked the Agricultural Department for years whether or not they really had people in that agency trying to focus on the question of how we can convert some of these surpluses without screwing up the economies we are trying to help develop. I have asked a lot of people that question.

I, frankly, never really have gotten an answer that is sharp enough or good enough in the past, not in just this administration, but a lot of them, the answers to two questions: Number one, what are the inhibitions that prevent us from being able to do a better job in transferring surpluses in this and other countries to areas that need them, grain and dairy; and, secondly, if I were to ask you to come up with a series of suggestions as to how we can significantly increase the use of dairy products in countries where you have shortages of food, what would your two responses be?

Mr. McPherson. As background, in fiscal year 1983, under the Section 416 program, where all that milk is available, we shipped 88,000 tons. We have been pushing hard to allocate the surplus during products and we know it can be used in Northeast Brazil because of the drought situation. I clearly mentioned what we are doing in Chile and some other places. In fiscal year 1985 we had 147,000 tons under the 416 program. Now, the agriculture bill incidentally has a minimum of 150,000 tons for the Section 416 program, which I think they will reach. It is pretty clear we ought to be able to, given that we had 147,000 tons in 1985.

Now, we have some requests that are in process for milk in Mexico and other places. When you move in with targeted milk, you want to make sure that you don't end up undercutting local production or export markets. In Guatemala and Bolivia, we talked about targeting 416 milk and cheese to those countries. We are working hard at trying to figure out how to increase this allocation. Our record in the last couple years is a pretty good one, and I want to improve that.

I can go into some of the problems, but you have heard them before. I remember when I was a Peace Corps volunteer in Peru, we had problems with milk in the schools, often it wasn't mixed exactly right. The kids got stomachaches, and people didn't want to use the milk after a while. Nevertheless, it is my judgment that we can do more, and I have asked my staff that we come up with an AID plan which we would share with you on how we might ultimately do so.

Mr. Obey. I would like to see that.

Mr. Lewis.

Mr. Lewis. Thank you, Mr. Chairman.

I wasn't going to mention it, Peter, but for the record the chairman and I do ask questions for each other from time to time. You probably didn't know Chino is in my district. It produces more milk almost than the entire State of Wisconsin. The chairman and I have a great interest.

Mr. McPherson. My interest would be in doubling it.

Mr. Obey. I think the gentleman is engaging in a little hyperbole.

### DISPOSITION OF ISRAELI SUPPLEMENTAL

Mr. Lewis. I will invite you to Chino. I remember a meeting with Israel's Finance Minister last year in the Capitol. I am not sure if you were present, I think you were, in which there was some in-depth discussion about a request for an additional $1.5 billion of assistance to Israel because of their economic circumstance. I would like to have, for the record, what happened with that money, what happened with the conditions that were implicit in that discussion.

Mr. McPherson. We would be happy to supply it.

[The information follows:]

### USE OF $1.5 BILLION SUPPLEMENTAL ASSISTANCE FOR ISRAEL

Half of the assistance, or $750 million was disbursed as a cash grant in September 1985. The disbursement was made in support of the economic stabilization program which the Israeli Government put into effect in July. The basic elements of the program were:

(1) increases in the prices of subsidized consumer goods and services ranging from 25 to 100 percent,

(2) increases in the prices of most other goods and services of 17 percent,

(3) a price freeze (subsequent to the above mentioned increases),

(4) wage adjustments designed to erode real wages during the last six months of 1985, and then permit them to rise again during the first quarter of 1986,

(5) reductions in the public service workforce,

(6) tax increases,

(7) reductions in expenditures of government ministries totaling approximately $530 million on an annual basis,

(8) an 18.8 percent devaluation of the shekel, after which the dollar/shekel exchange rate was to be stabilized for a time at IS1500=$1,

(9) abolition of foreign currency linked deposits (PATAM) which mature in less than one year, and

(10) a restrictive monetary policy featuring high real interest rates.

While the program is still too new to say anything definitive about its long term impact, economic performance improved markedly in the months following its announcement. The budget deficit shrank, inflation receded dramatically, the balance of payments picture improved, and foreign exchange reserves grew. Nevertheless, it is clear that additional measures will be needed to consolidate the gains made during the past several months. The budget deficit is still too large; further actions are needed to assure that domestic costs do not rise to a point which threatens Israeli competitiveness on world markets; more needs to be done to delink financial assets from domestic price indices and/or associated changes in the foreign exchange rate; and policy adjustments are needed to improve the climate for domestic and foreign investment.

The remaining funds from the supplemental will be disbursed in support of the government's continuing efforts to stabilize the Israeli economy and establish conditions favorable to self-sustaining, non-inflationary growth. No decisions have yet been made regarding the timing of future disbursements.

### SISTER CITY PROJECT

Mr. LEWIS. I have noted between 1984 and today that inflation has been radically reduced in Israel from 400 plus percent, down to the last quarter it looks like it could be between 12 and 15 percent. Unfortunately in the meantime, they have enforced wage and price controls, and you wonder about what those conditions really resulted in. I would like to see an equalization of that.

The other item, for the record, as you know, I am a strong advocate of building constituencies within our districts for foreign assistance programs, so one day David and I can go home and talk about the fact David and I work on this committee. One of the few sources around to help us do that, and one of the reasons for my own initiative to encourage privatization or participation among POs is that they have to build constituencies at home to get their private funding, that helps with this whole effort.

In that connection, POs seem to flow in and out of favor. There is one set of POs or PO operations that seemingly has fallen off the list of favor that does the job of promoting constituents at home, and that is the Sister Cities Program. I would appreciate if you would let us know why suddenly the Sister City Project has gone out of favor at AID.

Mr. MCPHERSON. I can respond right now if you want me to. We have felt the Sister Cities should be able to raise more of their own money.

Mr. Lewis. Is that an accounting problem or real problem? I gather they raise a lot of money and don't account it?

Mr. McPherson. They raise a lot of money for local use, but the monies for the national office that they have raised is quite limited. Now don't get me wrong, I think they do a good job.

Mr. Lewis. I got a feeling what is going to happen is overnight they are going to demonstrate they raise as much money or more as most others, because they are going to redefine it.

Mr. McPherson. We have given them a $25,000 grant for this year. That is down from about $100,000 last year. A few weeks ago, we were saying we didn't think they should get any. We have had long discussions and negotiations. They expect to apply for a grant next year, and although we haven't made a decision on it, it could be in the range of about $75,000.

My impression is that they feel that these discussions have concluded. That is a very recent development.

Mr. Lewis. I just asked my staff to kind find out for me which of my incorporated cities in my rather small rural district—you might help us do that for each of our members of this panel, so we know which of our cities are involved.

Mr. McPherson. It is a good idea. I think Sister Cities would be appropriate.

Mr. Lewis. Thank you. Thank you, Mr. Chairman.

### VITAMIN A EARMARKS

Mr. Obey. Mr. McPherson, just a few other questions. Vitamin A, last year the committee earmarked eight million bucks for that project. How are you spending it, and what do you plan that money to be used for, what organizations are receiving the funds?

Mr. McPherson. We haven't worked that all out, but we are planning to spend it. I have forgotten the name of the institution through which we would expect to spend a large portion of it. We know that Vitamin A reduces blindness. The matter of dispute is whether or not Vitamin A has a broader impact upon health.

Some tests, which we paid for in Indonesia and other places, suggest that maybe it does. We think that perhaps within the next 12 months or so we will know whether it has such a broad impact. Frankly, I wish the earmark hadn't been for eight million; rather, I wish it had been for three or four, to give us a chance to complete these tests before we launch onto another major drive. But it could be when these tests come out that instead of talking about ORT and immunization, I will be talking about Vitamin A as well. In the meantime, we are focusing this money to achieve the ends that we know about.

Mr. Obey. I agree that the eight million earmarking is much more reasonable than the 30 million requested, given the tentative nature of what you are producing, but I think it appears promising. I would like you to respond, I know I have had some physicians express the concern Vitamin A, if it is used in too large an amount, causes more problems than it can solve, and there has been a lot of concern—I shouldn't say a lot of concern—but there has been some concern expressed from physicians.

I am just wondering what it would really do to this program. What would you say to reassure people with that concern, that this program really does appear to be something which can have a positive impact on health in the area of the world we are talking about?

Mr. McPherson. The monitoring of the projects we have undertaken suggests that overdosage is not a problem. I had not heard of that ever expressed as a concern.

Like everything else, you need to do it right. We are talking about targeted populations where you have major vitamin A deficiencies.

### AID'S EGYPT PROGRAM

Mr. Obey. There are several other questions on Central America at this point, in Haiti and Egypt. I really don't know what to ask about Egypt in terms of their economic situation, because I share in Mr. Kemp's concern about squeezing the economy to such an extent it can cause political explosions instead.

By the same token, I have tremendous concern about the ability of the Egyptian Government, given the tremendous constraints on it, to achieve the kind of economic reform that you really have to have to make that country economically viable.

What comments would you have to make about the Egyptian program in general? What developing efforts has the Government of Egypt undertaken with respect to the provision of U.S. cash payments? What are the results of those efforts?

And in that respect, let me ask a second question, so I get both the Egypt questions on the table. In February, 1984, the GAO reported that those AID missions were unable to account for local currency generated by transactions that come out of the import program. The largest CIP was in Egypt, it was 300 million for both fiscal year 1983 and 1984, as I understand. I don't remember what it was for 1985. In 1985, the AID mission developed a system to implement, improve accountability in this CIP program. What has AID's experience been in that regard?

Mr. McPherson. I think that probably our most difficult experience has indeed been in Egypt. We insisted that local currency generated by the CIP be put in a jointly controlled account, which was GAO's concern and which I think they found satisfactorily addressed.

Frankly, I have been tightening up and worrying more about local currency generations from CIPs and from Public Law 480 Title I. Every year I worry more about them, because, as our budgets get tighter, we need to multiply our resources. I don't see local currency generation as a major problem today. I think a couple of years ago that was much more of concern—with Central America as well.

Egypt, is absolutely the classic case of the dilemma we face. On the one hand, you know that over time the Egyptian Government absolutely must exercise tighter control because we can't afford the money to continue to substitute for reforms of various economic policies. Egypt is a case in point, where the situation economically has gotten steadily worse. They have greater balance of payment problems, more debt, et cetera.

But to undertake these reforms is politically a very difficult thing. We saw this problem in Egypt just a few days ago, although not directly related to reforms, it was still obviously a problem. I go to Egypt probably twice a year, sorting through the heart of the problems, when to disburse and how much. Egyptians have, for example, increased the prices that farmers get for certain crops, and we think that has been helpful to production. They have increased the prices of petroleum that their people receive. We think that also has been helpful, although not as much as we think it should. There are still major steps that have to be taken.

How do we get some credit in the eyes of the Egyptian people for what we do? It is something that I have thought a lot about. We have done it by trying to focus in on a few key visible activities, such as the 90,000 children we have saved, through our ORT programs. We are building a massive sewer water system in Cairo—something everybody knows we are doing—which I think has had a real impact upon the nerve center of the country.

I know I haven't fully answered these questions. I have spent hours and days on each issue.

Mr. Obey. Why don't you respond further for the record and give us any information you want to.

[The information follows:]

### Accounting System for CIP Special Account

We have successfully implemented over the past year a new system to account for local currency generated by CIP. As of December 31, 1985, the downpayment arrearages for the CIP Special Account stood at $11.9 million as opposed to $28.3 million in September 1984; arrearages on principal were at $32.8 million down from $89.4 million in September 1984. We continue to work on these arrearages and expect in the near future another payment for $9.4 million against the downpayment backlog.

For all new transactions the system is working well. Egyptian banks are providing timely and accurate information. Neither A.I.D. nor the Ministry for Planning and International Cooperation (MPIC) will approve a financing request from any agencies or companies which have arrearages. MPIC will not forward a financing request to A.I.D. until the bank designated to participate in the transaction has actually received the downpayment and so notifies MPIC. In sum, we believe we now have the arrearages problem under control.

### ASSISTANCE TO GRENADA

Mr. Obey. One question on Grenada. My impression there is that the airport has been either completed or largely completed and the road has been refurbished. I understand unemployment is up, and that two U.S. companies that have started operations there have gone bankrupt. One of the owners is in jail for fraudulently obtaining loans to feed starving populations in Grenada.

What is actually happening there? What has AID actually been able to do in that country that has improved the conditions, the economic conditions of the people?

Mr. McPherson. We think there are, in process, a number of new investments. We are not going to turn it around overnight, but it looks to us like the power, the airport and some roads are improving. The infrastructure is beginning to set in place. We expect to have modestly better tourism and some additional investments. We think that the nutmeg surplus that was stored on the island when we got there now has been disposed of. The nutmeg business has substantially improved. In a way, agricultural production looks at least a little better. I think we are going to have a long-term major struggle.

The round trip air fare to Grenada, is about $700 from Washington, D.C. That doesn't attract business and tourism the way it should. In fact, one of the major questions, I think, throughout the Caribbean and Central America are air fares. I think we have to start looking at deregulation.

There are a number of questions and problems. We are making some progress, but not overwhelming. We can be reasonably pleased with some foundations, but I suspect we will continue to have to work on this.

Mr. **Obey**. All I can say is if we are going to talk about air fares, $700 round trip to Grenada is not very much more than a round trip to my district. I can fly to Los Angeles and back for half the cost of flying half way across the country to my own district.

### GRAMM-RUDMAN CUTS

The other questions I will leave for the record. I just want to again urge you, I keep doing this with every witness that comes before us. We have talked a lot about serious problems this morning. It has been a fairly substantive discussion. It would be nice if we could take substance into account when we deal with this budget.

The problem is that if we don't have an agreement between the big guy in the White House and the big guys on Capitol Hill about what we are going to do with our fiscal problems, we are not going to be able to worry about the niceties of policy in terms of foreign aid because we are going to be too busy trying to find bucks to meet Gramm-Rudman. Without that compromise, that means a decimation for most of the programs we have been talking about.

### AID REQUEST FOR EDUCATION

Just to review, in the area of education, you are asking for an increase of what percent? Is it 11 percent? Something like that.

Mr. **McPherson**. I have my numbers here.

Mr. **Obey**. Well, assuming it is 11 percent, are you asking for an increase—

Mr. **McPherson**. Eleven percent.

Mr. **Obey**. In the domestic budget you are scheduled for a 23 percent or, $1.1 billion cut, guaranteed student loans are cut 30 percent, adult education is cut 47 percent or $448 million.

In the area of agriculture, you are asking for a four to six percent, or about a $40 million increase. In the domestic budget, soil conservation programs, if we talk about environmental programs overall, soil and conservation programs at home are being cut 30 percent, by $194 million, the Agriculture Extension Service is being cut 59 percent, by $205 million, the Bureau of Water and Sea, $109 million, the Bureau of Housing by $1.1 million. That is eliminated entirely.

We have a housing project in foreign aid, but we are being asked to eliminate our rural housing problem on the domestic side. I have to say, with all due respect to OMB—I would say to the people putting together this budget the same thing Sam Rayburn said to Lyndon Johnson about Jack Kennedy's Cabinet, "I would just as soon one of them had run for Sheriff someplace before they got where they are." Because if they think you can go back home on Main Street in America and ask for a $2 billion increase in foreign assistance, most of which doesn't go unfortunately to your programs; it goes for the guns, not for the kids and not for the health and not for the education programs. But if they think that they can sell a $2 billion increase in foreign aid when they are cutting back programs like that, they are seeing a whole lot of different people than I am seeing every time I go home to my district; and I am sure it is the same with the other members' districts on this side of the aisle, or that side of the aisle.

There was a lot of needling yesterday about whether we were for revenue increases or not. I just have to say that we can have it one way or we can have it the other, but we can't have it both ways, and having it both ways is trying to finance the $200 billion increase in foreign aid at the same time we are trying to pretend we are interested in budget balancing. We are going to get that budget balanced through a compromise which includes some kind of revenue package, or we are going to get the budget balanced by cutting the living guts out of the programs we know shouldn't be cut that deeply, including yours.

Thank you very much.

## Questions and Answers for the Record

### UNITED STATES ASSISTANCE TO HAITI IN THE POST-DUVALIER PERIOD

Mr. OBEY. Background—Since 1973, following a decade of non-assistance for political reasons, the United States has provided economic and military assistance to Haiti, primarily through Development Assistance and Food for Peace programs. Considering the population (about 6 million) and the dire poverty in Haiti, the amount of U.S. assistance has been limited (less then half of the aid to Jamaica or the Dominican Republic), largely because of concern about the corruption, inefficiency and repression associated with the Duvalier government. Moreover, Congress has required that assistance be provided through private and voluntary organizations (PVOs) to the maximum extent practicable, and only if the President determined that Haiti was cooperating with the United States to halt illegal emigration and to carry out aid programs, and was making progress to improve the human rights situation in the country. The Administration suspended most aid under the last provision in late January 1986, but announced release of the aid on February 26, 1986, citing improvements under the new council.

What assurance do we have that the military-civilian council will retain the support of the population and move the country toward democracy and economic development, considering that most of the members of the council and the recently appointed cabinet are closely associated with the previous Duvalier governments? Assuming the best, when would you expect elections to be held in Haiti?

ANSWER. We agree that economic development can only take place in the context of a popularly-supported, stable government. It appears that the National Council of Government (CNG) continues to enjoy broad support, particularly since the dismissal of council and cabinet members most closely associated with Duvalier which took place after your hearings. We are pleased with the CNG's commitment to move toward elections as soon as a proper groundwork has been laid, although we are hopeful that a timetable will be set before long.

The CNG has begun implementing its democratization plans. Release of political prisoners, abolition of the notorious militia known as the Ton Ton Macoutes, and the presidency-for-life, complete press freedom, freedom for labor unions, commitments to a democratic political structure, and planned elections at all levels of the Haitian government—this is the antithesis of what Duvalier stood for.

An educational process will be required to avoid a repetition of the historic cycle in which demagogic politicians lead Haiti into a new dictatorship. This is recognized by a spectrum of responsible Haitians, including Catholic church leaders, although there is pressure from many to get the democratic processs underway more rapidly. While I cannot predict a timetable, the USG is exploring ways to assist the CNG in Haiti's democratic transition leading to presidential elections.

### ASSISTANCE TO HAITI

Mr. OBEY. Are the present aid levels for FY 86 and FY 87 adequate for Haiti, or is the administration considering reprogrammings or modifications during this window of opportunity for promoting democracy?

a) What amounts and types of aid are likely to be most effective?

b) How will the aid encourage the movement toward democracy and political pluralism?

c) Is the administrative capability in Haiti adequate to absorb additional assistance?

ANSWER. The current U.S. assistance program provides a solid base for addressing Haiti's long-term development needs. Its principal areas of focus are stabilization of the agricultural base, export-led private sector investment and production, and basic education and health services with emphasis on child survival. At this point, given our severe budget constraints, we are not planning a major reprogramming, although it is possible we may consider limited reprogramming. We are pursuing the following actions and watching closely the economic situation as it develops.

Short term needs, however, require special attention, and some measures beyond those earlier planned for FY 86. Because Haiti's severe long-term development problems have been aggravated by a near-term foreign exchange crisis, constraining its capacity to import food and petroleum, we have initiated a number of actions to help provide some relief.

In order to encourage progress towards democracy and political pluralism, recent assistance initiatives will help assure a measure of economic stability during which time this process can proceed. This assistance also supports diplomatic initiatives to encourage the movement towards democracy.

Participation in development programs which directly benefit recipients—including job creation—will be stressed. Food donations, careful programming of local currencies, and continuation of targeted development programs in such areas as health, rural road maintenance, rural water system rehabilitation and construction, support this process. In addition, to help maintain reliable supplies of wheat, we have already supplied 15,000 MT to Haiti under Title II to arrive in late March, sufficient to meet about one month's requirements, and have approved another 17,000 MT of wheat and 5,000 MT of edible oil.

Local currency from the sales of this wheat will be used, in part, to create jobs for the unemployed. Additional PL 480 assistance is being considered, and a PL 480 Title III program for FY 1986, which would supply both wheat and vegetable oil for several months, has been approved. This additional food assistance will provide substantial balance of payments relief.

We are providing Haiti with technical assistance in petroleum marketing and procurement. We have also offered Haiti other technical assistance, including experts to shore up the Haitian government's economic team and administrative capability. We are also reviewing the employment-generating potential of A.I.D.'s current portfolio of projects, as well as of Title II and Title III local currency generations.

The administrative capability within Haiti continues to be of concern, particularly in the delivery of services and supplies—especially foodstuffs—to the poor nationwide. For this reason, among others, we will continue to place heavy reliance on existing PVO networks in implementation of many of our activities, while examining opportunities to strengthen the administrative capacity of selected government institutions to better manage national economic development.

We have been encouraging other donors to help meet Haiti's needs. While their ability to respond to the emergency situation is limited, we are optimistic that they will provide long-term development support. We will watch this situation carefully and keep the Congress informed regarding any additional resources that may be required, including any additional to the FY 1987 request which, as you know, was prepared before the fall of the Duvalier regime.

### ASSISTANCE TO HAITI THROUGH PVOs

Mr. OBEY. The GAO's June 1985 report on "United States Assistance to Haiti" suggested that channeling large amounts of aid through a proliferation of private and voluntary organizations (PVOs) may create coordination and oversight problems and may detract from the need to strengthen Haiti's governmental institutions for managing development activities. Especially in light of the new circumstances in Haiti, should PVOs be emphasized as much as in the past?

ANSWER. Private Voluntary Agencies (PVOs) provide an important link in the delivery of U.S.—and other donor—assistance to the poor majority on a nationwide basis. Manpower and financial weaknesses of the central government over many years in Haiti have seriously limited the delivery of such services through the public sector. Consequently, while we and others are considering programs to help strengthen the capacity of the government, we expect to continue to provide a significant portion of our assistance through PVOs. Coordination and oversight problems of the PVO programs are minimized by use of an established mechanism centered in the A.I.D./Port-au-Prince Office of Private Voluntary Development. We believe it has been effective.

## AGENCY POLICY ON PROVIDING PESTICIDES UNDER THE COMMODITY IMPORT PROGRAM (CIP)

Mr. OBEY. Estimates of obligations for environment/forestry/natural resource activities in FY 87, show a substantial increase over FY 86 program levels although they are considerably below FY 85 levels. Agency obligations for environmental/natural resource activities are expected to total about $280 million in FY 1987 compared to a level of $220 million in FY 1986 and $397 million in FY 1985.

The attached table shows estimates of projected obligation levels by type of activity. Total obligation levels fluctuate greatly from year to year in large part due to changes in the levels of ESF funds provided for capital intensive water and sewer projects in the Near East region. An examination of funding trends in other categories shows that support of forest management activities has been increasing each year, while there appears to have been a decline in cross-sectoral or integrated projects such as watershed management or soils management.

Projects designed to promote the conservation of biological diversity are included in forestry, integrated land and multiple resource management, and the category called other environmental. However, some of the Agency's biological diversity activities such as these dealing with agricultural research or germ plasm collections do not appear in these figures.

The table does not include support provided from PL 480 local currency accounts which are being used for environmental activities, especially forestry or activities funded through disaster relief programs which are being used to restore degraded natural resources.

In a January 22 letter from Sierra Club, Natural Resources Defense Council, National Wildlife Federation, Environmental Defense Fund and Audubon Society, (attached), it is stated that you are relaxing the prohibition on the use of pesticides in the CIP program, making major changes in the settlement. Proposed changes in CIP pesticide use wouldn't even take into consideration the new A.I.D./World Bank pesticide policies.

This is important in consideration of the fact that in FY 84 alone more than $140 million in fertilizer, synthetics, compounds, and drugs were purchased under CIP without any real guidelines.

Do we even know whether for instance any of these substances are banned for use in the U.S. under OSHA or EPA?

ANSWER. A.I.D. is not relaxing its policy or the environmental procedures that govern the way pesticides can be supplied under the Commodity Import Program. It has been and remains A.I.D. policy that CIP financing of pesticides is not permitted except in a very few instances when a waiver by the Administrator is appropriate based on emergency conditions or compelling circumstances.

A.I.D. Missions have rarely used this approach and our effort in developing guidelines is not intended to encourage use of CIP financing for pesticides. Rather our purpose is to clarify the conditions and circumstances under which a waiver may be considered. Request for a waiver should describe the emergency condition or compelling circumstances which prompt the request. The supporting documentation should also show the Environmental Protection Agency registration of the requested pesticides and the local safety precautions that will be taken. It must also show that an environmental review has been completed which is as effective for the proposed program as the review required when pesticides are procured under project assistance.

This is not a relaxation of the circumstances under which the Agency will be prepared to finance pesticides in a CIP. The emergency conditions or compelling circumstances standards of the pesticide procedures must be satisfied. We expect few, if any requests on this basis. If there are any, however, they must also satisfy the additional guidance regarding the environmental review which is necessary before presentation to the Administrator.

A.I.D. does have vigorously-enforced commodity eligibility policies or guidelines that are designed to ensure that we will not finance unsafe or ineffective products. We are not aware of any fertilizer, synthetic, compound, or drug procurement under the CIP which involves a substance banned for use in the U.S. under FDA or EPA.

AGENCY ACTIVITY IN FORESTRY, ENVIRONMENT AND NATURAL RESOURCES (DA AND ESF)

[In thousands of dollars]

| Agency totals | Fiscal year— | | |
|---|---|---|---|
| | 1985 (actual) | 1986 (estimate) | 1987 (request) |
| Forestry | 37,726 | 43,555 | 50,887 |
| Integrated land and multiple resource management | 37,177 | 29,665 | 18,695 |
| Soils management | 10,286 | 170 | 160 |
| Rangeland management | 3,225 | 0 | 0 |
| Water resources management | 51,389 | 25,279 | 39,205 |
| Pollution control | 8,063 | 0 | 1,000 |
| Water quality improvement [1] | 230,460 | 115,742 | 167,175 |
| Other environmental | 19,159 | 5,442 | 2,664 |
| Total | 397,495 | 219,853 | 279,786 |

[1] This category includes major investments for water and wastewater systems.

## ACCOUNTING SYSTEM FOR CIP SPECIAL ACCOUNT

Mr. OBEY. In February 1984, GAO reported that most AID missions were unable to account for local currency generated by transactions in the Commodity Import Program (CIP). AID's largest CIP is in Egypt; it was $300 million in both fiscal year 1983 and 1984 and $200 million for 1985. In January 1985, the AID mission in Egypt developed and started to implement a system to improve accountability for local currency generated by the CIP. Effective implementation of this system requires the mission to obtain timely and accurate information on CIP transactions from Egyptian banks.

What has been AID's experience in the first year of implementing the new system to account for local currency generated by the CIP in Egypt? Have Egyptian banks submitted timely and accurate information to the mission on CIP transactions?

ANSWER. We have successfully implemented over the past year a new system to account for local currency generated by the CIP. As of December 31, 1985, the downpayment arrearages for the CPI Special Account stood at $11.9 million as opposed to $28.3 million in September 1984; arrearages on principal were at $32.8 million down from $89.4 million in September 1984. We continue to work on these arrearages and expect in the near future another payment for $9.4 million against the downpayment backlog.

For all new transactions the system is working well. Egyptian banks are providing timely and accurate information. Neither A.I.D. nor the Ministry for Planning and International Cooperation (MPIC) will approve a financing request from any agencies or companies which have arrearages. MPIC will not forward a financing request to A.I.D. until the bank designated to participate in the transaction has actually received the downpayment and so notifies MPIC. In sum, we believe we now have the arrearages problem under control.

## INTERNATIONAL FUND FOR AGRICULTURAL DEVELOPMENT

Mr. OBEY. Mr. McPherson, last year Congress provided $30 million for IFAD, based on completion of replenishment negotiations. Have those negotiations now been completed? Have the IFAD funds been transferred as part of the replenishment, when will that occur? There is no Administration request for IFAD in FY 1987. How do you plan to fund the U.S. share for FY 1987? Do you anticipate an FY 1987 budget amendment to accommodate the IFAD funding level for FY 1987? IFAD has always been funded as a separate line account under the International Organizations and Programs, why is the method of funding being changed?

Answer. The second replenishment negotiations were concluded on January 23 when all members approved a $460 million replenishment.

The agreement reached in January was based on a $184 million level of contribution from the OPEC donors. However, some were hopeful that this figure could be increased and the January agreement allowed for additional contributions from the OPEC donors, with a proportional matching amount from the OECD donors. No such additional amounts were forthcoming from the OPEC donors and the replenishment level stands at $460 million.

Under the second replenishment agreement, the OPEC donors have pledged $184 million (40 percent) and the OECD donors have pledged $276 million (60 percent).

The U.S. contribution amounts to $79.8 million for the three year replenishment period, and the approximate U.S. share of both the total replenishment (17%) and the Category I (OECD donors) contribution (28%) have been maintained.

Regarding the transfer for the FY 1986 funds for IFAD's second replenishment, our instrument of contribution for the second replenishment will be processed as soon as the Administration's request for the appropriated funds is submitted to the Congress.

As for subsequent payments, no funds were requested in the Administration's FY 1987 budget submission because at the time the budget was prepared there was not yet an agreement on the replenishment. It is the Administration's intention to provide funds for the FY 1987 and FY 1988 portion of the U.S. pledge to IFAD's second replenishment (CY 1985–CY 1987) from within the Administration's overall foreign aid request levels. An FY 1987 budget amendment will be forwarded to the Congress at the appropriate time. The method for funding IFAD is currently under review.

## HOUSING GUARANTY PROGRAM

Mr. OBEY. Mr. McPherson, this Committee has strongly supported the AID Housing program. But, this year you are again requesting a contribution to its reserve fund.

In 1985, you got $40 million for the reserve fund. Now, you are asking for another $10 million.

What do you propose to do to stem the problem of debt renegotiation losses in the Housing program in the future?

What legislative solutions are you considering?

If these losses continue, the Committee will have to consider directly appropriating the HIG funds, but you should know that getting direct appropriations is more difficult.

Answer. Housing Guaranty (HG) reserves are used to pay claims of U.S. lenders when less developed country (LDC) borrowers fail to make their debt service payments. Claims resulting from LDC public debt rescheduling are having an increasing impact on the HG reserve account and soon will comprise the majority of total claims. In such cases, HG reserves are used to service the debt during the agreed debt deferral period. Thereafter, the deferred debt is repaid to the HG reserve account plus interest. On the assumption that sovereign nations as a whole will continue to honor their debts, these payments will be recovered. However, the HG reserves need to have sufficient liquid cash assets to meet demands of debt rescheduling.

In order to deal with the debt rescheduling situation, A.I.D. has taken the following steps: (a) instituted a Claims Projection System in order to project claims expenditures against the HG Reserve Fund; (b) established a procedure for undertaking country risk analyses which rate the risk of lending to different countries based on HG program experience, current economic indicators and private investment community perceptions; (c) designed, and is implementing, a computerized Portfolio Management System which will provide information on claims on a more timely basis, thus helping to reduce late payments and increase income from late payment fees; and, *significantly,* (d) initiated a "refinancing" program for refinancing HG loans otherwise subject to deferral and rescheduling.

The refinancing program is intended to reduce the HG reserve account's liquidity problem. Under the refinancing option, a private lender makes the rescheduled payments, and accepts repayment under the schedule provided in the rescheduling agreement. The debt position of the debtor nation remains the same, but this debt is now owed to the private lender who made the payment rather than to reserve fund, which does not make the payment. A.I.D. is attempting to negotiate the first refinancing agreements in FY 86 and will have a much better understanding of the feasibilty of the proposal after the first couple of negotiations are undertaken. The goal is to refinance about half of the net claims. However, since at present the option to refinance is that of the borrower, it may be difficult to accomplish as much as we would like to.

It is anticipated that net claims against the reserve fund will average $10-15 million in each of fiscal years 1986, 1987, and 1988. At the beginning of FY 1986 the HG Reserve Fund totaled $36.1 million. To cover the balance of claims which are not projected to be refinanced, the Reserve Fund would be drawn down by $9.5 million in FY 1986, $7.0 million in FY 1987, and $6.7 million in FY 1988, leaving an insufficient balance for FY 1989 operations. Therefore, for FY 87, $10 million will be required to increase the level of the HG Reserve Fund to cover claims which have not been refinanced. Our FY 1988 budget will update this analysis and will reflect actual experience with refinancing.

In answer to the question about possible legislative solutions considered (in addition to the refinancing approach and appropriations for the Reserve Fund), we are reviewing additional courses of action which we will be discussing with the Congress after our own position is clearer.

## ECONOMIC POLICY REFORM IN EGYPT

Mr. OBEY. Egypt's economy is distorted by a costly and complex set of price controls and subsidies. What progress has the Government of Egypt made in changing these economic policies? How has A.I.D. helped to promote these changes?

ANSWER. The recent sharp decline in oil prices, coming on top of already severe structural problems, has created a new sense of urgency among Egypt's economic leadership, although a framework for a comprehensive economic reform program, approved last summer, has not yet been fully implemented. During the past year the government has:

Cut food subsidies, with wheat procurement prices now almost at U.S. levels.

Reduced energy subsidies by moving electricity prices up 37 percent, gasoline prices up 25 to 33 percent, and doubling the price of fuel oil for the generation of electricity.

Cut back on consumer imports to some degree in concert with a number of more modest steps such as raising airline fares.

While these steps have been in the right direction, they have not been sufficient to reverse the downward trend in budgetary and balance of payments deficits. A.I.D. has been engaged in extensive discussions with Egyptian policy-makers during the course of the past year and there has been considerable agreement about the reform agenda, including the areas of highest priority, i.e. budget and balance of payments deficit reduction, improved debt management and an expanded role for the private sector. Also, A.I.D. has encouraged the Egyptians to seek broad support from other bilateral and multilateral donors who have expressed a willingness to support the government's difficult reform program. Acceleration of the reform process has been called for by President Mubarak despite the February disturbances, and the Egyptian cabinet has given assurances that new measures will be introduced soon.

## CASH TRANSFER SUPPORT FOR EGYPTIAN ECONOMIC REFORM

Mr. OBEY. What development efforts has the Government of Egypt undertaken in response to the provisions of U.S. cash payments? What have been the results of these efforts?

ANSWER. Cash transfer assistance has provided immediate disbursing balance of payments support to Egypt at a time when that country is experiencing serious economic difficulty. It has also facilitated initiation of our macro economic policy dialogue. The result to date, in exchange for U.S. cash disbursements, has been substantial agreement between the U.S. mission and the government of Egypt on the economic reform agenda, and the Egyptians have taken some important steps. As Secretary of State Shultz has indicated, however, implementation of reform has thus far fallen far short of the comprehensive effort needed to achieve long-term viability.

In March, President Mubarak ordered the cabinet to accelerate implementation of the government's economic program. We look forward to early enactment of a program that will combine essential short-term remedies with long-range structural adjustment of the economy.

## MONITORING CASH TRANSFER CONDITIONALITY IN EGYPT

Mr. OBEY. How does A.I.D. determine whether Egypt is keeping the economic development commitments made in exchange for U.S. cash payments?

ANSWER. Cash transfer assistance under the regular ESF program has in the past been subject to a side letter requiring that amounts equivalent to cash payments be disbursed for health and housing in Egypt. Monitoring has included written verificiation by the government that such expenditures have been made.

Under the $500 million supplemental, cash disbursements were linked to progress in economic reform. Progress has been monitored by staff analysis and regular high level discussions that have identified the components essential in a comprehensive program including reduction in government subsidies (food, energy, transportation), better debt management, and encouragement of the private sector.

## GROWING OUT OF DEBT PROBLEMS

Mr. OBEY. The A.I.D. strategy for many developing countries is to encourage them to "grow out" of their debt problems by increasing and diversifying their exports.

How can countries which by and large produce the same products—sugar, coffee, bananas, copper—which are surplus on world markets and which are declining in proce, hope to "grow out" of their problems?

Can you tell me what A.I.D. recipient countries have "grown out" of their debt problems in the last six years?

Answer. A.I.D. strategy is based on the four pillars which support growth and developmental progress in host developing countries: policy dialogue, encouragement of the private sector, institution building and technology transfer. We apply this strategy not only in our bilateral programs but also in the directions we encourage the multilateral institutions and other bilateral donors to take. Increasingly, these institutions and donors are talking along these lines.

Recognition on the part of the international community that growth is a critical factor in determining the ability of the developing countries to manage their debt service obligations is a positive forward step. Wider recognition of the role of growth and the need for policy changes to support the private sector and market oriented development owes much to the Program for Sustained Growth debt initiative put forward by Treasury Secretary Baker. This initiative has received support from donors and others. Its implementation will require the combined efforts of all countries and institutions concerned.

Many developing countries are responding to the need for major policy changes to overcome the domestic obstacles to growth and development. Despite the unfavorable outlook on some commodity prices, other international economic conditions are becoming more favorable to growth, for example, through the effects of lower interest rates and lower oil prices, which provide a stimulus to growth in the industrialized and developing countries. Growth in turn stimulates trade and affords all countries greater opportunities to increase exports.

Many developing countries still rely heavily on a few commodities for a major portion of their export earnings. Some commodities such as coffee are providing increased earnings at present, but sustained increases in export earnings for many developing countries will depend on diversification and expansion of their exports. Some low and lower middle income countries have greatly expanded their exports of manufactures over the last 15 years. Examples include India, Pakistan, the Philippines, Thailand, Ivory Coast, Peru and Costa Rica. Others are still in the early stages of economic transformation, but over time, many developing countries should be able to diversify their exports both to other developing countries and to industrialized countries.

How rapidly this can occur will depend on world economic growth, the adoption of appropriate policies in the developed and developing countries and the maintenance of a reasonably open world trading environment.

The last six years have witnessed a severe recession in the world economy and a strong recovery in the United States. Economic performance in most countries has been mixed, with many developing countries only gradually moving toward recovery. It was in the context of the oil price hikes of 1979/80 and the world recession of the early 1980s that the LDC debt problem emerged. This reflected the fundamental change in world economic conditions, which made all debt more difficult to manage and exposed a substantial amount of unwise borrowing. Since that time creditors and debtors have worked jointly to ameliorate the problem. However, it will take substantial time for heavily indebted LDCs to grow out of their debt problem.

Most developing countries demonstrate some promise of being able to grow and to manage their debt service over the next few years, provided the world economic situation continues to improve. Some A.I.D. recipient as well as other developing countries most probably will require debt rescheduling during this period, and a few suffer from such serious economic problems and heavy debt burdens that they are not likely to grow out of their difficulties in the near term.

The debt problems of the developing countries must be considered on a case-by-case basis. Appropriate actions will vary from country to country and over time. But a growth orientation offers the greatest promise that a large majority of developing countries will be able to manage their debt service obligations and gradually build their creditworthiness.

It must be remembered that despite fluctuations and cycles in commodity prices, there is no substitute for taking the right road to long term structural adjustment and growth, not only to improve the quality of life of LDC populations, but to enable the LDCs to cope with these inevitable adverse fluctuations in commodity prices.

## USE OF A.I.D. AUDIT AND EVALUATION REPORTS

Mr. OBEY. With hundreds of audit and evaluation reports being done by your staff each year and with your need to tighten expenditures and shift monies to where the highest payoffs can be found, can you tell us how your top executives use this information in making future budget decisions?

Please provide us with a sense of how you are integrating these management systems with your budget decisions.

ANSWER. The A.I.D. Inspector General's (IG) audit reports are constantly reviewed by A.I.D. management officials in ensuring efficient and effective use of foreign assistance dollars. The Agency's Audit Follow-up System provides a systematic means of ensuring adequate and proper corrective actions on all IG audit findings. This follow-up process requires almost daily involvement by A.I.D. top management in resolving or ensuring appropriate action on IG recommendations.

Evaluation in A.I.D. is driven by the information needs of planners and managers. The focus on utilization encourages evaluations to be responsive to short-term operational requirements and to ensure that long-term planning, policy formulation and budget decisions benefit from A.I.D. experience.

Evaluation work is timed to key decision points in the program, planning, project design and budget cycle. Senior A.I.D. executives and managers, both abroad and in Washington routinely use the results of evaulation in:

Decisions about continuing, terminating or redirecting projects and programs;

Decisions on the planning of future activities based on A.I.D.'s understanding of factors that advance development;

Formulation of A.I.D. policies and procedures to assure that they are effective management instruments supportive of A.I.D.'s mission; and

Broad resource allocation decisions.

Evaluation as an element in A.I.D.'s comprehensive planning processes extends beyond the level of specific project and non-project activities. Greater use of evaluation findings and lessons is evidenced in the preparation of long-term A.I.D. country development strategies and has resulted in clearer statements of strategy benchmarks against which results can be measured. The country development strategy reviews which make broad resource allocation decisions are chaired by Senior A.I.D. executives.

Mr. OBEY. Is there a systematic way which your executive staff considers the burden of this mass of findings?

ANSWER. The IG's office also issues periodic "Flash Reports" which summarize to all A.I.D. managers significant problems or deficiencies found by recent audit efforts. This document provides a lessons learned from audits which A.I.D. managers should consider in improving the day-to-day management of the foreign assistance programs. These Flash Reports highlight audit findings and provide recommendations for improving the efficiency and effectiveness of A.I.D. expenditures.

Synthesis of evaluation findings and lessons learned is particularly important for policymakers, planners and project designers as one basis for selecting and comparing alternatives. A.I.D.'s evaluation staff emphasizes the analysis, synthesis and dissemination of experience in selected development topics. The application of lessons learned is promoted through the dissemination of "impact" evaluation and special reports, in abstracts and syntheses and executive summaries for top managers. Evaluations are also being designed to cut across traditional evaluation categories and topics. Over the next year A.I.D., through evaluations, will examine three major cross cutting issues affecting the quality of development assistance which are of interest to senior management, namely, project sustainability, women in development and environmental impact. The lessons learned will be utilized by senior management and more generally in the design and management of the Agency's program.

Overseas missions prepare annual work plans which use benchmarks and utilize evaluation findings to assess the effectiveness of mission programs. These work plans are then used by senior agency management to validate the extent to which strategic program objectives are being met.

Mr. OBEY. Do you have major recommendations from the stream of audits and evaluations which you now have before you or have you ordered new series of audits and evaluations aimed at showing where you ought to get out of business and where you are having the highest payoffs?

ANSWER. The audit process provides information mostly on how well the Agency manages those activities it has undertaken. Generally, audits do not show where A.I.D. is having its highest program payoffs or the lowest program payoffs. We could be managing a poor program payoff project well and get good audit results. Evaluations of projects and longer term impact evaluations are much more helpful in determining areas where A.I.D. is having better programmatic payoffs.

Evaluation is a continuing element in A.I.D.'s planning and management system. A.I.D.'s new series of policy papers, which shapes current programs, draw on evaluation experience, including the cumulative findings of the agency's "impact" evaluations. Evaluations in contraceptive social marketing, small farmer credit, education, and alternative approaches that show promise in promoting technology transfer in agriculture extension are significant areas where evaluations helped shape policy guidance.

To enable managers and designers to draw more directly and effectively on the full range of the agency's experience, A.I.D.'s Center for Development Information and Evaluation, established in 1983, has several initiatives underway. They are:

Comparative evaluations on the effectiveness of alternative approaches for achieving the same objective. An evaluation series on problems in managing agricultural projects in Africa has been completed leading to a synthesis on improving African institution building and project management. Work in other areas including transferring of agro-processing and food marketing system technologies is underway.

Comparative evaluations of similar projects in different settings to identify the more effective and sustainable models. A recent study reviews A.I.D. experience with crop and income substitution programs in five countries and outlines some of the key factors bearing on successful programs to reduce narcotics production.

The intended impact of these initiatives combined with routine monitoring and evaluation is to guide U.S. assistance into more effective and efficient programs.

## AID PRIVATIZATION IMPACT

Mr. OBEY. Your Agency has made a significant number of initiatives, including most recently a major international conference on privatization, to foster an increased private sector role in the developing countries.

After having been at it for five years in some cases emphasizing existing programs but in many cases pushing new activities, what evidence do you have that poor people have benefited more than any other approach which has been tried?

How are you watching out for the employment and other effects hoped for to help poorer people?

What specifically can you state are the ways which people are the main focus of these activities?

ANSWER. A.I.D.'s private enterprise initiative is based not only on the historic record of economic progress achieved through private enterprise in our own country, but also on the recent experience of many developing countries. This experience demonstrates that developing countries that have encouraged private enterprise and competitive markets have, over the past decade, achieved per capita growth rates at more than twice the levels of developing countries that have relied on economies controlled and directed by governments. Some nations, notably Taiwan and Korea, have used market forces to power a dramatic transition from A.I.D. recipient to A.I.D. graduate. Invigoration of a country's private sector has direct benefits for the majority of its people, including those from lower economic strata.

A.I.D.'s private sector projects and programs are designed, monitored, and redesigned or terminated as circumstances dictate. As many of the new initiative projects are reaching a phase that invite evaluation, evaluative efforts are being accelerated. As these activities are evaluated, A.I.D. will be able to provide more definitive information on program impact. Preliminary indications are that A.I.D.'s private sector initiative program has been helping to make developing country economies more market-responsive, has led to the creation and expansion of many indigenous enterprises, and has had a substantial impact on employment generation.

In implementing its private sector initiative strategy, A.I.D. has concentrated on activities that fully support the Congressional mandate to improve the lives of the poor majority in A.I.D.-assisted countries. The emphasis is on job creation and income expansion, especially in labor-intensive smaller enterprises in rural areas; human resources development through skills training; and self-help host country policies that best promote self-propelling and equitable growth that reaches the largest number of people.

The private sector initiative, from inception, has focused on agribusiness as a key provider of jobs, increased income, and value-added agricultural exports as well as a stimulus for developing countries' farm income and production. Within A.I.D., over the past five years, the Bureau for Private Enterprise (PRE) has been charged with serving as A.I.D.'s private enterprise leader, motivator and laboratory and with working with other A.I.D. Bureaus in developing new projects and programs that not only provide specific development benefits on their own, but which may serve as models for replication or expansion by A.I.D. field missions.

A.I.D. loan projects are designed almost exclusively for targeted smaller enterprises that provide jobs, wages and opportunities in their areas. These projects are often weighted toward the more impoverished areas of the host country. Congressional guidelines for the Private Sector Revolving Fund, which funds major PRE investments, specify small business and cooperative beneficiaries. This is a dynamic force for development which is often overlooked in official donor programs. Examples include the loan pools established in Siam and Kenya Commercial Banks which are well into the process of creating some 1500 jobs in rural Thailand and Kenya, as is Thailand's first modern private meat processing plant, which is partly capitalized with A.I.D. funds, and which expects outreach to some 2000 small farmers and suppliers.

Through policy dialogue with developing country governments, policy reofrm is encouraged as a means of correcting distortions that artificially encourage capital over labor, including unrealistic pricing policies. Developing countries are encouraged to rely on labor intensive technologies. For example, in Bangladesh, as a result of policy dialogue, retail fertilizer prices were decontrolled in 1983. Restrictions were removed on the movement and sale of fertilizer by private dealers. Wholesaling at the local level was transferred from the public to private sector. The result has been the creation of circumstances favorable for the development of new small, medium and micro-businesses—a major objective of the program. Private distribution and marketing at the national level, including wholesaler access to factories and ports is being accomplished in phases. Sales increased by 15% during FY 1983 and by a further 18% in FY 1984. The last phase is presently underway.

In Latin America and the Caribbean, A.I.D. has provided financial and techncial resources for approximately 176 private enterprise projects. These projects focus on economic growth and financial stabilization; encouragement of production, trade and investment in nontraditional exports; and enhancement of production, management and marketing capabilities of the business community. A.I.D. is currently working with Costa Rica in the divestiture of 90% of its state-owned enterprises. This will open up new opportunities for the development of micro, small and medium-sized businesses.

In addition to projects that relate solely to private enterprise development, private sector organizations such as cooperative development organizations (CDOs) and other private and voluntary organizations (PVOs), businesses or labor organizations participate in projects which cover areas as diverse as credit availability, pricing, manufacturing and facility development, export development, and promotion of nontraditional exports. CDOs and PVOs are able and willing to provide assistance through technology transfer to small, micro-enterprises in the poorer regions of many developing countries and are particularly suitable for person-to-person services needed in developing countries. This is especially true in the remote rural areas and urban centers of Africa.

## AID Obligations and GDP Growth

Mr. McHugh. AID obligated more assistance for Central America in 1985 than in any previous year. As the attached table suggests, however, GDP growth was at best anemic. Could you explain why?

Answer. The region's economic growth in 1985 was disappointing, with an overall regional growth rate of 0.6%, compared to 1.5% in 1984, and to an original target of 2.2%. Nevertheless, growth in several countries—Honduras, Panama and El Salvador—was at or near our earlier targets.

Several important factors were involved. Prices of Central America's main commodity exports declined further from 1984 levels, capital inflows into the region were lower than anticipated, world interest rates remained higher than we anticipated, and economic policy performance was inadequate in several cases. Guatemala (which was received only limited U.S. assistance) went through a financial crisis during 1985. In Costa Rica, unfavorable weather conditions sharply reduced its banana production and exports, leading to a slowdown in growth. In El Salvador, the continued high level of violence, and continued suspicious between the public and private sectors, has limited the pace of economic recovery. Doubtless, the Nicaraguan situation and resultant uncertainties have also reduced foreign investment and intra-regional trade in Central America.

We expect a significant improvement in economic performance during 1986, with the overall rate of economic growth in the 3-4% range. Higher coffee prices and lower oil prices and interest rates will help. El Salvador's growth is expected to continue to be sluggish, but Costa Rica, Honduras and Belize should all show GDP growth rates that are positive on a per capita basis. For Guatemala, a broad-based democratic government has since taken power, and a return to positive growth in 1986 is expected, provided Guatemala takes the type of actions now under discussion.

As always, the extent of progress in Central America will depend heavily on each country's own economic measures, as well as on external developments.

### PER CAPITA GDP GROWTH RATES, CENTRAL AMERICA

| Country | 1980 | 1981 | 1982 | 1983 | 1984 | 1985 |
|---|---|---|---|---|---|---|
| Belize | 1.8 | −1.8 | −7.4 | −1 | −1.2 | −1 |
| Costa Rica | −2.1 | −4.7 | −9.7 | −.1 | −3.1 | −1.4 |
| El Salvador | −12.4 | −11.3 | −8.6 | −2.2 | −1.5 | −1.4 |
| Guatemala | 6 | −2.4 | −6.6 | −5.8 | −2.4 | −4.4 |
| Honduras | −.8 | −2.3 | −5.3 | −4 | −.7 | −1 |
| Panama | 3.6 | 1.8 | 3.1 | −2 | −3 | −.5 |
| Regional total [1] | −1.6 | −3.4 | −5.5 | −3.6 | −1.5 | −2.4 |

[1] The regional total is a weighted average, based on 1985 World Bank figures. Alternative weighting systems would give somewhat different results. For example, weighting with 1979 GDP data would have produced a larger drop in regional GDP during 1981–83.

Mr. McHugh. Following up on my question regarding GDP growth in Central America, could you provide for the record a table similar to the one attached that details per capita GDP growth?

Answer. The requested table is provided below:

### ANNUAL GROWTH RATES OF GDP, 1980–85—CENTRAL AMERICA

[In percent]

| Country | 1980 | 1981 | 1982 | 1983 | 1984 | 1985 |
|---|---|---|---|---|---|---|
| Costa Rica | 0.3 | −2.3 | −7.3 | 2.3 | 5.5 | 1.0 |
| El Salvador | −9.4 | −8.3 | −5.6 | .8 | 1.5 | 1.0 |
| Guatemala | 3.7 | .7 | −3.5 | −2.7 | .7 | −1.3 |
| Honduras | 2.8 | 1.2 | −1.8 | −.5 | 2.8 | 1.0 |
| Panama | 6.0 | 4.2 | 5.5 | .4 | −.6 | 1.9 |
| Belize | 4.3 | .9 | −5.7 | 1.0 | 2.0 | 1.0 |
| Regional total [1] | 1.4 | −.4 | −2 5 | −.6 | 1.5 | .3 |

[1] The regional total is a weighted average, based on 1985 World Bank figures. Alternative weighting systems would give somewhat different results. For example, weighing with 1979 GDP data would have produced a larger drop in regional GDP during 1981–83.

## PROSPECTS FOR REAL PER CAPITA GDP GROWTH

Mr. MCHUGH. You are asking us to continue pouring more than $1 billion in economic aid into Central America for the indefinite future. When can we expect to see some progress in terms of increased per capita economic growth?

ANSWER. The Administration's program, based on the conclusions of the Kissinger Commission, calls for high levels of assistance through 1989. The request is based on an integrated program aimed at achieving 6% economic growth throughout the region by 1989. It should be noted, however, that the cummulative funds available from appropriations through FY 1986 are 20% less than the recommendations of the Bipartisan Commission. Because of several factors, most notably the continued political violence in the region and world economic conditions, recovery in the region has so far gone more slowly than we anticipated.

Economic policies are the most important single determinant of economic growth rates. Considerable progress has been made in improving the policy framework in Central America, though much remains to be done. We still consider the 6% growth by 1989 target feasible for several countries, including Costa Rica, Belize, Panama and possibly Guatemala and Honduras. In El Salvador, however, the target is very unlikely to be acheived unless the negative impact of the insurgency declines dramatically. In all the countries, moreover, achievement of the goal will require continued progress toward improved economic management. Subject to these and other external factors, we anticipate economic growth in the region in 1986 in the 3-4% range—the highest rate in seven years. On a per capita basis, growth will be between zero and one percent. For 1987 and subsequent years, we project higher economic growth rates, and faster per capita growth, again depending in large part on world economic factors and whether violence is reduced.

## TRADE CREDIT INSURANCE PROGRAM

Mr. MCHUGH. In his testimony last year, Administrator McPherson called the Trade Credit Insurance Program "an extremely valuable short-term tool" that was needed to get "commercial activity going" in Central America. Yet, the GAO has just issued a report indicating that there has been limited use of this authority. Why?

ANSWER. The TCIP, which was proposed by the National Bipartisan Commission on Central America as a way to increase the flow of imports into Central America, has not been implemented as rapidly as we would have expected. There are several reasons for this. As with any new program in developing countries, there were delays in getting started. It was not until the spring of 1985 that the first guarantees were approved by the Export-Import Bank.

There are certain country-specific factors which have limited the utilization of the program to date. Monetary authorities in El Salvador have established a ceiling for short term dollar indebtedness with foreign banks. This ceiling, in turn, has impacted on the utilization of the TCIP in that country. In Costa Rica, the central bank is confronted with a legal problem concerning its ability to undertake the repayment guarantees which the program requires. We would hope that, with time, such obstacles will be surmounted.

It has also been suggested that the effective demand for trade credits in Central America may have been overestimated, and that other factors such as low world prices may have also inhibited this demand. There are some indications that this is true, but it is too early to make a definitive judgment on the matter. We will look at that issue in an evaluation of the program which we plan to do later in FY '86.

In the meantime, the TCIP has had a positive impact, even though it has not met expectations. It has enabled certain Central American countries to secure additional short-term commercial credit, and has caused such credit to be provided on more favorable terms—*e.g.*, lower costs, and without a requirement for cash collateral.

Mr. McHugh. In your FY 1986 congressional presentation document, you indicated that this program would be used "to finance inputs for agricultural and industrial production which, in turn, will generate employment, incresaed production and help earn sorely needed foreign exchange." Yet, the GAO report indicates that the program is being used primarily to finance consumer goods. It also notes that it was used to finance the import of 496 Spanish Bibles and bathroom accessories. Could you explain the discrepancy between stated purpose and actual use?

Answer. The TCIP is not being used primarily to finance consumer goods, and the GAO report does not so state. The report gives examples of imported items used for the *production* of consumer goods, but that is quite a different matter, and is consistent with the purposes of the TCIP.

The report did point out that a few consumer items, particularly bathroom accessories and bibles were financed under the program in Honduras. This should not have occurred, even though they represented only a very small percentage of the items and amounts funded under the program. Our missions have since made very clear to appropriate authorities in each country the purposes of the program and stressed the importance of assuring compliance with its criteria.

## CONSTRAINTS TO CENTRAL AMERICAN GROWTH

Mr. McHUGH. If lack of available credit is not a constraint to increasing Central American exports, what are the constraints?

ANSWER. Short-term credit does not appear to be a significant constraint to exports from Central America, but we consider the lack of availability of longer-term investment credit as a significant limiting factor. There are a number of other constraints to Central American exports, many of which our assistance programs are seeking to address. These include:

*Inappropriate economic policies.*—Some countries have maintained overvalued exchange rates, export taxes, and other impediments to export growth. Significant progress has been made over the past year or two in improving such policies, but further steps are needed in some countries.

*Military conflict and violence.*—This has been a serious impediment to new investment in export production in much of the region.

*Protectionist restraints by trading partners.*—In some cases, notably textiles and sugar, exports are limited by import quotas in industrial countries. The CBI legislation has provided increased access to the U.S. market for a wide range of products, but our declining quotas for sugar have had an adverse impact. Central American exports of sugar to the U.S. in 1985 declined by $100 million from 1984.

*Excessive government regulations.*—In some cases, exports are restrained by government paperwork requirements, or other regulations that make it difficult for firms to move quickly to respond to export opportunities. AID Missions have worked to identify and eliminate such bottlenecks.

## TRADE CREDIT INSURANCE PROGRAM

Mr. McHUGH. In FY 1985 you set aside $60 million to cover any bad debts under this program. At the end of the fiscal year, however, $50 million of this amount was reprogrammed for other uses. Why?

ANSWER. At the beginning of the program, we had the responsibility to set aside sufficient funds for contingent liabilities. In the absence of any experience with the program, we conservatively estimated that a 20%, or $60 million, reserve should be programmed.

As we approached the end of FY 85 it became apparent that, given the slow start of the program and the consequent small risk exposure of AID, the $60 million initially reserved to cover bad debts was not needed in FY 85. At the same time, other important Central American projects which had been developed lacked funding. It seemed to us quite reasonable to utilize the funds not required in the reserve for other high priority uses in the region.

Accordingly, as set forth in Congressional Notifications during the year, $35 million was reprogrammed to fund a project with the Central America Bank for Economic Integration (CABEI) to fund public sector infrastructure; $11 million was reprogrammed for a project with the Centro Agronomico Tropical de Investigacion y Ensenanza (CATIE) to help establish a regional institution for higher education in agriculture; and $4 million was utilized to help initiate the "Strengthening Democracy" project which is designed to strengthen democratic institutions and increase citizen participation in the political process in Central America.

Mr. McHUGH. In FY 1986 you asked for an additional $40 million to cover bad debts, and GAO reports that you plan to reprogram some of those funds if they are not needed for that purpose. Yet, you are now asking for another $25 million to cover bad debts in FY 1987. Could you explain why you keep reprogramming money that we provide for one purpose for other uses instead of simply keeping funds available for this purpose?

ANSWER. We are trying to manage our ESF funds in such a way as to assure the availability of adequate reserves to cover any risk of loss under the TCIP, while at the same time seeking to maximize the utilization of available ESF for high priority activities in Central America. Accordingly, while we originally established a $60 million reserve in FY 1985 based on a conservative estimate of our risk exposure, at the end of that year we reduced this reserve to $10 million (which we obligated by agreement with Eximbank) when we reviewed our risks in light of the slow start of TCIP and the consequent small risk exposure at that time.

For FY 1986 and FY 1987 we requested amounts for the reserve fund based upon our best estimate, at the time the Congressional Presentation was prepared, of the likely requirements. During FY 1986 we will again review our risk exposure under the TCIP. If we find that not all of the funds in the reserve are required, we will utilize the excess for other important requirements in Central America that were underfunded because appropriations were less than requested. We believe that it is sensible to use our ESF in this way rather than let millions of ESF dollars sit idly in a TCIP reserve "pipeline". Because of slower implementation to date than expected, we have already reduced the FY 1986 reserve funds from $40 million to $27 million—$19 million in regional funds, and $8 million from country programs.

### CENTRAL AMERICA COMMON MARKET FUNDS

Mr. McHUGH. In 1985 AID requested $95 million in ESF to provide emergency credit to the Central American Common Market Fund. Subsequently, AID decided not to provide funding to the Common Market Fund. Why?

**ANSWER.** AID's request for assistance for the Central American Common Market was established in response to a recommendation by the Kissinger Commission. Subsequent to our request, an AID contracted study recommended against emergency credit to finance the settlement of trade balances within the Central American Common Market, because the imbalances were due to misaligned exchange rates. Providing the credit to the Central American Common Market Fund would have helped to clear the imbalances but would not have stimulated trade over a sustained period because of the differences in some countries between the the overvalued exchange rates and their real values. Realigning these currencies would both stimulate trade and clear the imbalances between countries.

Mr. McHUGH. What was done with the funds appropriated for this purpose?

**ANSWER.** There were no funds specifically appropriated for the Central American Common Market Fund (CACMF). Total FY 1985 ESF made available to Central America was $105 million below the Administration request. The Central American Regional program (which included the CACMF funding request) absorbed a large proportion of the reduction, and was reduced to $70 million from a requested level of $136 million.

**ANSWER.** The $70 million ESF available to the Central American Regional program was obligated as follows:

[Dollars in millions]

| *Project* | *Amount* |
|---|---|
| Regional Agricultural Education | $11.0 |
| Regional Economic Recovery (CABEI) | 35.0 |
| C.A. Energy Resources (Los Alamos) | 5.0 |
| Trade Credit Insurance Reserve | 10.0 |
| Regional Administration of Justice | 4.0 |
| Strengthening Democracy | 5.0 |

### REGIONAL OFFICE FOR CENTRAL AMERICAN PROGRAMS [ROCAP]

Mr. McHUGH. Why are over half of AID's regional program funds for Central America currently being managed by AID/Washington and/or the bilateral missions rather than by ROCAP?

**ANSWER.** There are a number of answers to this question, as it involves a number of activities. ROCAP's personnel mix does not include the specific skills needed to manage certain of the activities begun under the Central American Initiative. Others such as the Regional Administration of Justice and the Democracy projects involve sensitive bilateral issues requiring policy oversight and the attention of our bilateral missions.

The Central American Peace Scholarship (CAPS) program, on the other hand, is shown as an AID/W project for accounting purposes. CAP funds, while they carry a regional project designation, are in fact allocated to individual missions, including ROCAP, which select, process and manage the participant training project in the field. AID/W performs only a coordinating, backstopping and monitoring role under this program.

The Trade Credit Insurance Program is managed by the Export Import Bank with close coordination and consultation with AID.

Finally, it should be noted that the Los Alamos Energy project which is shown as an AID/W project was recently transferred to ROCAP for management as ROCAP now has an energy advisor.

Our preference to the extent feasible is that all projects that impact on the region or countries within it be managed in the field, by ROCAP or one of our bilateral missions, whichever is most appropriate. I do not believe there has been a sufficiently clear delineation of what is managed in Washington and what is managed in ROCAP, however, and it is our plan to shift more of the Central American projects to the field as circumstances permit.

## ROCAP AND THE PROJECT DEVELOPMENT PROCESS

Mr. McHugh. How does AID insure that there is no duplication between regional and bilateral programs in Central America?

Answer. AID insures there is no duplication between regional and bilateral programs largely through its project development process. Projects indentified by ROCAP are first discussed with the USAID missions, after which each mission reviews the projects identification document. Mission comments on regional projects are required before ROCAP examines the project feasibility and once again after projects are prepared. At this stage and before projects are approved for funding, missions are required to review the fully developed project paper and submit their comments to AID/W and ROCAP. These comments are provided through official cables and become a matter of official record for each regional project. This system has worked well, but not perfectly.

## JUSTIFICATION FOR CONTINUING ROCAP

Mr. McHugh. Prior to the report of the Kissinger Commission, AID had reportedly decided to phase out ROCAP due to its perceived ineffectiveness. In an era of scarce resources, is there any justification for continuing ROCAP?

Answer. ROCAP has supported development objectives in the region through a variety of institutions dedicated exclusively to regional economic development. If there were no ROCAP, we woud need to find another way of handling its activities. These activities include efforts to:

Support the bilateral missions with technical and administrative assistance in areas where these missions do not have sufficient staffing and expertise, particularly in this period of tight AID budget and limited staffing ceilings;

Develop regionwide development data, analyze Central American regional trends, and make appropriate recommendations.

Continue to improve capability to the key regional institutions to help overcome several major problems and constraints to development or to fill development needs that almost all Central American countries face in common:

CABEI, The Central American Bank for Economic Integration is financing large transportation and infrastructure projects.

CATIE, The Central American Research Institute for Tropical Agriculture is providing research and training in watershed management, the control of agricultural pests, and systems to increase small farm production and other environmental, scientific, and educational activities which promote agriculture.

INCAE, The Central American Institute for Business Administration is the region's Harvard developed post graduate facility which provides training and research in management, marketing, and other business administration specialties including risk exposure and export management.

ICAITI, The Central American Institute for Technology is helping industry, agroindustry, and small business to conserve energy, adapt appropriate technologies, and improve quality controls.

INCAP, The Central American Institute for Food and Nutrition assists governments in Central America with research and program development to improve infant survival rates, growth monitoring and improved nutrition.

These institutions among others have the capability of mobilizing scarce human resources to focus on the resolution of long-term problems, a capability not yet possessed by most of the countries in the region.

## STATUS OF EL SALVADOR LAND REFORM AND FINANCIAL VIABILITY OF PHASE I COOPERATIVES

Mr. McHugh. Some time ago your Inspector General issued a report that raised questions about the prospects for success in El Salvador's land reform program. Could you give us an update on the land reform program, especially in terms of financial viability of Phase I cooperatives?

Answer. Progress in the implementation of El Salvador's land reform has been slow but relatively steady since the Inspector General's report in 1984. The major indicators for Phase I and III as of January 31, 1986 are:

| | Phase I | Phase III |
|---|---|---|
| Beneficiaries (incld. family members) | 188,154 | 382,008 |
| Title applications (Phase III) | | 79,142 |
| Cooperatives (Phase I) | 317 | |
| Final Titles | 133 | 17,249 |
| Compensation paid (in millions) | | |
| Bonds | $185 | $11 |
| Cash | $15 | $11 |

With respect to Phase II, the new Salvadoran constitution has increased to 605 acres the limit on individual land holdings. Landowners with more than 605 acres have until December 31, 1986 to sell their land or face the possibility of expropriation without prior compensation. The GOES has not yet enacted implementing legislation to deal with those cases where a landowner has not complied voluntarily with the constitutional limit, but we believe it important that the GOES find ways to avoid expropriation. One critical factor affecting the financial viability of the Phase I cooperatives is the agrarian reform debt which will require a major restructuring as a first step to self-sustaining financial viability. We are presently exploring approaches whereby the Government of El Salvador would:

(1) Reduce the interest rate on the debt,

(2) Extend the grace and amortization periods, and

(3) Freeze the emergency production credit received during the first weeks of the reform in 1980.

In concert with the proposed debt restructuring the GOES has established the goal of completing the titling process for Phase I by the end of 1986. Increased allocation of GOES-owned local currency for compensation will help speed this process.

Another very important factor affecting the viability of these cooperatives is our work with the GOES to increase the independent status of these cooperatives as private enterprises through enhancement of beneficiary rights and by strengthening the roles and responsibilities of the beneficiaries in the management of their enterprises.

The combined effect of these actions now underway will be to reduce the cooperatives' financial burden, increase individual incentives and improve the level of cooperative management by bringing in professional private sector farm managers responsible to the cooperative members. The armed conflict also affects the reform cooperatives, at times making success impossible. As many as 50 cooperatives have been totally or partially abandoned, and others have incurred direct and indirect losses because of the war. As long as the violence continues, it represents an additional major obstacle to the financial well-being of the reform cooperatives.

### Population Assistance—DeConcini Amendment

Mr. McHugh. Has A.I.D. issued regulations to implement the policy of voluntarism and informed choice reflected in passage of the DeConcini amendment last year? If so, could you make a copy available for the hearing record? If not, could you tell us what steps you are taking to implement the amendment?

Answer. A.I.D. is currently developing a standard provision for grants and cooperative agreements to implement the DeConcini amendment. We will provide you with a copy when it is completed.

### Population Assistance—UNFPA Support

Mr. McHugh. Does A.I.D. plan to make a contribution to the U.N. Fund for Population Activities this year?

Answer. Although the 1986 legislation does not earmark funds for the U.N. Fund for Population Activities (UNFPA), A.I.D. has set aside approximately $30 million in 1986 for a contribution fo UNFPA. A.I.D. has been UNFPA's largest contributor since its inception and does not want to harm the Fund. However, A.I.D. is required to provide assistance in accordance with legislative restrictions which, in 1985, led to A.I.D.'s judgement that UNFPA was ineligible for A.I.D. support because of the assistance UNFPA provides to the population program of China. Currently, A.I.D. has no information that suggests sufficient changes in either UNFPA's program or in the Chinese program to make the Fund eligible for an A.I.D. contribution.

### AGENCY FOR INTERNATIONAL DEVELOPMENT HOUSING GUARANTEES

Mr. McHUGH. Your budget does not include a request for housing guarantees in Fiscal Year 1987. Why not?

ANSWER. As part of the overall Executive Branch efforts to curtail guaranty programs, A.I.D. is not requesting authority to issue new guarantees for FY 1987 and beyond.

Mr. McHUGH. You are seeking funds, however, to replenish the housing guarantee reserve fund. We provided $40 million for that purpose in Fiscal Year 1985, and as I recall we were encouraged to believe that this would be sufficient for several years at least. Why has the fund been depleted so quickly?

ANSWER. Housing Guaranty (HG) reserves are used to pay claims of U.S. lenders when less developed country (LDC) borrowers fail to make their debt service payments. Claims resulting from LDC public debt rescheduling are having an increasing impact on the HG reserve account and soon will comprise the majority of total claims. In such cases, HG reserves are used to service the debt during the agreed debt deferral period. Thereafter, the deferred debt is repaid to the HG reserve account plus interest. On the assumption that sovereign nations as a whole will continue to honor their debts, these payments will be recovered. However, the HG reserves need to have sufficient liquid cash assets to meet demands of debt rescheduling. The recent $40 million appropriation to HG reserves has met the emergency needs of the program but has not resulted in a HG reserve account that is adequate to meet the needs of the $1.3 billion portfolio as discussed earlier with the Congress. Claim payments are contractual obligations of the U.S. and must be paid. As things now stand, the Reserve Fund is the only available source for such payments.

In order to deal with the debt rescheduling situation, A.I.D. has: (a) instituted a Claims Projection System in order to project claims expenditures against the HG Reserve Fund; (b) established a procedure for undertaking country risk analyses which rate the risk of lending to different countries based on HG program experience, current economic indicators and private investment community perceptions; (c) designed, and is implementing, a computerized Portfolio Management System which will provide information on claims on a more timely basis, thus helping to reduce late payments and increase income from late payment fees; and, significantly, (9) initiated a "refinancing" program for refinancing HG loans otherwise subject to deferral and rescheduling.

The refinancing program is intended to reduce the HG reserve account's liquidity problem. Under the refinancing option, a private lender makes the rescheduled payments, and accepts repayment under the schedule provided in the rescheduling agreement. The debt position of the debtor nation remains the same, but this debt is now owed to the private lender who made the payment rather than to the reserve fund, which does not make the payment. A.I.D. is attempting to negotiate the first refinancing agreements in FY 86 and will have a much better understanding of the feasibility of the proposal after the first couple of negotiations are undertaken. Our goal is to refinance about half of the net claims. However, since at present the option to refinance is that of the borrower, it may be difficult to accomplish as much as we would like to.

It is anticipated that net claims against the reserve fund will average $10 to $15 million in each of fiscal years 1986, 1987, and 1988. At the beginning of FY 1986 the HG Reserve Fund totalled $36.1 million. To cover the balance of claims which are not projected to be refinanced, the Reserve Fund would be drawn down by $9.5 million in FY 1986, $7 million in FY 1987, $6.7 million in FY 1988, leaving an insufficient balance for FY 1989 operations. Therefore, for FY 87, $10 million will be required to increase the level of the HG Reserve Fund to cover claims which have not been refinanced. Our FY 1988 budget will update this analysis and will reflect actual experience with refinancing.

### HAITI—ASSISTANCE IN DEMOCRACY

Mr. DIXON. I believe Congress and all of America are pleased to see that democracy does work. In the case of the Philippines and Haiti, the people determined the fate of their countries, and now both dictators are in exile. In the case of Haiti, what is the Administration proposing to help the interim government move the country towards democracy? Could you elaborate on the proposal?

ANSWER. The Administration has been encouraging the new government to hold democratic elections. The President of the National Council of Government has promised to work toward elections of a new National Assembly and of a President. Release of political prisoners, abolition of the notorious militia known as the Ton Ton Macoutes, and of the presidency-for-life, complete press freedom, freedom for labor unions, commitments to a democratic political structure, and planned elections at all levels of the Haitian government are very positive steps towards institution of democracy in Haiti. Among actions the Administration has taken are provision of emergency supplies of wheat and vegetable oil and technical assistance to help assure a measure of economic stability within which political reforms can take root. In addition, expanded Voice of America Creole language broadcasts now include civic awareness programs. We have encouraged the National Endowment for Democracy to fund several proposals in Haiti, including one which will conduct public symposia on evolving political issues, and AIFLD has begun to fund labor union training programs. Senior Administration officials have visited Haiti and have expressed our support for the democratization objectives of the provisional government.

While major difficulties lie ahead, United States policy will continue to support these democratic objectives, economic development, and progress in the areas of human rights in Haiti, and we believe the present situation offers hope for the future despite the seniors economic challenges the nation faces. These include weak institutions to implement development programs, shortages of skilled manpower to design and carry out such programs, very limited natural resources—particularly in agriculture—upon which future development would rest, especially in rural areas, and the unrealistically high expectations of a people who expect rapid, tangible improvement in their living standards in the post-Duvalier era.

### HAITI—EMERGENCY ASSISTANCE

Mr. DIXON. If there is expected to be an "emergency aid" package, reprogramming or additional support for Haiti, when are you expected to present it to Congress?

ANSWER. Haiti's severe long-term development problems have been aggravated by a near-term foreign exchange crisis constraining its capacity to import food and petroleum. We have already delivered 15,000 metric tons of wheat under PL 480 Title II, to meet Haiti's needs for one month. The wheat arrived in Haiti in late March. Local currency from the sales of this wheat will be used, in part, to create jobs for the unemployed.

We have already approved additional emergency PL 480 assistance of wheat and vegetable oil. Negotiations for the already planned FY 1986 PL 480 Title III program, which would supply both wehat and vegetable oil for several months are underway. This food assistance provides substantial balance of payments relief. We are providing Haiti with technical assistance in petroleum marketing and procurement, and have offered Haiti other technical assistance, including experts to shore up the Haitian government's economic team. The employment-generating potential of A.I.D.'S current portfolio of projects, as well as of Title II and Title III local currency generations, is being closely reviewed.

We believe the current U.S. assistance program provides a solid base for addressing Haiti's longer-term needs. Its principal areas of focus are stabilization of the agricultural base, export-led private sector investment and production, and basic education and health services, with emphasis on child survival. Other donors are being encouraged to respond to the emergency situation in Haiti; we are hopeful that some balance of payments relief will be forthcoming. We will watch the emergency situation carefully and keep the Congress informed regarding any additional resources which may be required, including any in addition to the FY 1987 request which, as you know, was prepared before the fall of the Duvalier regime.

### FUNDS ACCOUNTABILITY

Mr. DIXON. In the case of the Philippines, there are reports of alleged kickbacks and misuse of U.S. military assistance. Could you please explain, to the best of your knowledge, if the current investigation only involved military aid and are you certain that A.I.D. can account for funds it obligated to the Philippines.

ANSWER. To the best of our knowledge, the existing investigation involves only the military assistance program and not the A.I.D. ESF program in spite of recent press reports that have stated there are substantial amounts of ESF unaccounted for. Our A.I.D. Mission has reported that we can account for the funds provided under our ESF program. An exact accounting for expenditures for all ESF activities through December 1985, will become available by March 31.

For example, A.I.D. tranferred $47.5 million to the GOP in December 1984 and $45 million in December 1985. The former was for the bases-related economic assistance program and the latter provided dollar balance of payments support. Of the total $92.5 million, only $11.2 million has been spent for agreed-upon activities, the remaining $81.3 million remains unspent. These remaining funds will be available for expenditure during FY-1986.

On March 19, 1986 the Philippine Commission on Audit stated it uncovered unexplained disbursements of $1.75 million (35 million pesos) from interest earnings in the ESF special account into a confidential account which was used for "payment of miscellaneous expenses of the President". However, our A.I.D. Mission in Manila has been in contact with the Philippine Audit Commission and have been told that, as yet, none of the funds in question have actually been attributed to ESF associated pesos in the special project account. Moreover, our records and statements from the Philippine National Bank where the ESF special account is located, reveal no such withdrawals of either interest or principal for the purposes alleged by the Audit Commission. A.I.D. was aware in January of the desire by Marcos Government officials to make withdrawals from the special account, and objected because it believed the withdrawals would be used for programs not approved by A.I.D. To our knowledge the withdrawals were not made. A.I.D.'s internal accounting system continues to provide us, on a monthly basis, information on program expenditures necessary to closely monitor and track A.I.D. disbursements.

## EMERGENCY FOOD AID

**Mr. DIXON.** There has been much discussion over the past few months both in Congress and among private voluntary organizations, of AID's, new and unprecedented policy of funding only 50 percent of "inland" transportation cost for emergency food aid to Africa. This policy has been implemented despite the fact that Congress appropriated $225 million for African food aid (presidential reserve) that could be used for "inland" transport of food. INTERACTION has opposed this and PVOs have indicated to our staff that they will either cancel emergency rehabilitation projects or withdraw from emergency food distribution projects activities if the 50 percent rule is maintained. They also resent government efforts to force them to use private donations, often earmarked for specific rehabilitation efforts for internal transport, which is unprecedented. How does AID justify reversing this policy, which endangers both the participation of PVOs in distribution food aid and their contributions of more than $300 million in emerging rehabilitation needs (seeds, tools, cattle, water wells, etc., recently documented by the U.N. Office of Emergency Operations headed by Brad Morse?

**ANSWER.** The authority to pay for internal transport of PL 480 food is a new one. It stems from a recommendation of the Presidential study on world hunger carried out in 1984. The Administration sought this authority to assure that our emergency food aid was indeed delivered quickly and effectively. The authority was never intended to assure complete funding of PVO feeding programs.

A.I.D. believes that P.L. 480 Title II emergency feeding programs with PVOs must be carried out cooperatively, as occurs in regular non-emergency programs. This cooperation requires A.I.D. and the PVO to each assume part of the financial burden and a degree of commitment for the Title II program. For FY 86 emergency Title II programs, A.I.D. will pay for the commodities, ocean freight, inland transport to landlocked countries and up to 50% of internal transportation within countries. It is not unreasonable to request PVOs to pay a portion of one of these items, the internal transportation, to ensure the joint nature of the endeavor. Otherwise, the PVO functions only as a contractor delivering U.S. food for a price. The PVO community raised well over $100 million from private contributions and it is appropriate for them to use a small portion of these resources to help fund the cost of internal transportation.

## A.I.D. ASSISTANCE TO LIBERIA

**Mr. DIXON.** Last month, the House passed a "Sense of the Congress" resolution regarding suspending military aid to Liberia, and at the same time, placed conditions on economic assistance. While this is a non binding resolution, what is A.I.D.'s position with regards to Liberia? What is the FY 1986 funding level, and does A.I.D. intend to move forward with project funding or determine if the Liberian Government is meeting certain conditions before moving forward with its activities.

**ANSWER.** A.I.D. is certain mindful of the House resolution, which places conditions specifically on disbursement of Economic Support Fund assistance. No FY 1986 ESF funds have been disbursed for Liberia to date, and the conditions contained in the House resolution will be a major consideration in decisions on when or whether to disburse these funds. In addition, a number of economic conditions will have to be met before the ESF funds can be disbursed.

The proposed FY 1986 assistance funding level for Liberia is $43.377 million. Of that level, $28.7 million is proposed for Economic Support Fund assistance, and $14.677 in Development Assistance funds is proposed to provide incremental financing for a number of important development activities which directly benefit the people of Liberia. Four of these programs are being implemented by non-governmental agencies. In addition, an $11 million PL 480 Title I program is proposed to provide rice imports to feed the population and provide counterpart for the development budget.

## A.I.D. REPORT ON PVO'S

Place in the record at this point the A.I.D. Report entitled "PVO Private Resource Test", submitted in compliance with the request by the House Appropriations Committee as contained in H. Rep. No. 99-252, pp. 37-38. The information follows.

# PVO PRIVATE RESOURCE TEST

Submitted by the

Agency for International Development

February 1986

# PVO PRIVATE RESOURCE TEST

As requested in the Report of the House Appropriations Committee accompanying the committee's version of the FY 1986 foreign assistance appropriations bill (H. Rep. No. 99-252, 99th Cong., 1st Ses., August 1, 1985, pp 37-38, attached), this report examines which PVOs are affected by the 20 percent private resource test as enacted in the 1986 Foreign Assistance Appropriations Act (the Appropriations Act) (P.L. 99-190) and by potential future increases in this private resource test.

Background: The Appropriations Act contains new legislation concerning PVO grant eligibility which supersedes the 20 percent private resource test established under Sec. 123(g) of the Foreign Assistance Act of 1961, as amended (FAA). Specifically, the legislation states that:

> None of the funds appropriated or otherwise made available in this Act for development assistance may be made available after January 1, 1986, to any United States private and voluntary organization, except any cooperative development organization, which obtains less than 20 per centum of its total annual funding for international activities from sources other than the United States Government.

The Conference Report (H. Rep. No. 99-450, 99th Cong., 1st Ses., December 19, 1985) accompanying the legislation and a statement by Senator Kasten provide additional guidance to A.I.D. in making the calculation. Excerpts are attached.

Guidelines to Implement the Private Resource Test: The following guidelines have been developed by A.I.D. for implementing the PVO private resource provision.

1. Effective Date. January 1, 1986.
2. Scope of application. The provision applies to all Development Assistance and is not limited to PVO-initiated activities or A.I.D. activities reserved exclusively for registered PVOs as the previous legislation. The provision applies to all United States PVOs except the cooperative development organizations. A United States PVO which fails to meet the 20 percent provision continues to be eligible to compete for all contracts, and to receive assistance from the Economic Support Fund and the disaster and refugee assistance accounts.

3. Calculation. Excluded from the calculation of United States Government support for a PVO are commodities contributed by the government for overseas distribution programs and related transportation costs, contracts for services, and assistance for A.I.D.-initiated activities. A.I.D.-initiated activities are those activities which PVOs conduct as intermediaries for A.I.D. These forms of assistance are not set aside or reserved exclusively for PVOs. The calculation is based on information provided by PVOs on A.I.D. FORM 1550-2 together with a PVO's audited financial statements, documents which must be submitted annually for recertification as a registered PVO.

4. Waiver. Unlike Section 123(g) of the FAA, the PVO private resource provision of the Appropriations Act does not contain authority for the A.I.D. Administrator to waive the requirement.

5. Compliance in FY 1986. On-going FY 1986 PVO programs for which the Congress has been notified may be continued even if the PVO does not meet the 20 percent private resource provision.

Impact of the Private Resource Test: Based on the most recent financial information available, 9 of the 176 registered[1] PVOs are not eligible for A.I.D. development assistance because they fail to meet the minimum 20 percent test. These organizations are listed in section A, Attachment 1. Two other PVOs are not eligible due to their delinquency in submitting current financial information and we are, therefore, not able to make a calculation of their privateness. These organizations are listed in section B, Attachment 1.

If the private resource requirement were raised from 20 percent to 25 percent, under their current funding arrangements, another 3 PVOs would not be eligible for funding; from 25 percent to 30 percent, another 3 organizations would be affected. These organizations are listed in section C, Attachment 1.

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[1] Since the Agency maintains a central data base only on registered PVOs, we are not yet in a position to gauge the full impact of the 20 percent provision on non-registered PVOs.

Attachments:

1. List of PVOs adversely affected by a 20-30 percent private resource test.
2. Report request from House Appropriations Committee, H.R. No. 99-252, pp.37-38.
3. Conference Report (H.R. No 99-450) statutory language.
4. Conference Report (H.R. No. 99-450) excerpt clarifying 20 percent provision of P.L. 99-190.
5. Statement by Senator Kasten clarifying 20 percent provision of P.L. 99-190.

Attachment 1

A. PVOs ADVERSELY AFFECTED BY THE 20 PERCENT PRIVATE RESOURCE TEST (P.L. 99-190)

| PVO NAME | PERCENT PRIVATE |
|---|---|
| Aid to Artisans | 4 |
| Center for Applied Linguistics | 0 |
| High Scope Educational Research Fdtn. | 2 |
| National Council for International Health | 0 |
| National Office for Social Responsibility | 1 |
| New TransCentury Foundation | 0 |
| Booker T. Washington Foundation | 0 |
| Wisconsin-Nicaragua Partners | 0 |
| World Education Inc. | 11 |

B. PVOs INELIGIBLE BECAUSE A CALCULATION CANNOT BE MADE*

| | |
|---|---|
| Consortium for Community Self-Help | N/A |
| National Council for Negro Women | N/A |

C. PVOs ADVERSELY AFFECTED BY A 25-30 PERCENT PRIVATE RESOURCE TEST **

| | |
|---|---|
| Africare | 22 |
| Int'l. Human Assistance Program | 25 |
| National Assoc. of Partners of Alliance | 24 |
| Partnership for Productivity Foundation | 27 |
| Simon Bolivar Foundation | 28 |
| Sister Cities International | 26 |

* Current financial information not on record.

** Assumes same language as P.L. 99-190, substituting 25 or 30 percent for 20 percent.

THURSDAY, MARCH 6, 1986.

## SECURITY ASSISTANCE OVERVIEW

### WITNESSES

**HON. WILLIAM SCHNEIDER, JR., UNDER SECRETARY FOR SECURITY ASSISTANCE, SCIENCE AND TECHNOLOGY, DEPARTMENT OF STATE**

**LIEUTENANT GENERAL PHILIP C. GAST, DIRECTOR, DEFENSE SECURITY ASSISTANCE AGENCY, DEPARTMENT OF DEFENSE**

### STATEMENT BY CHAIRMAN OBEY

Mr. OBEY. I have been stalling for about three minutes because I was told we were going to have a vote immediately at 11:00 upstairs, and I was hoping we could get that out of the way before the hearing began. Evidently it has never happened. Somebody has changed their plans.

We have as our witnesses today the Honorable William Schneider, Jr., Under Secretary for Security Assistance, Science and Technology, Department of State, and Lieutenant General Philip C. Gast, Director of Defense Security Assistance Agency, Department of Defense.

Gentlemen—Mr. Schneider, you were with the Secretary earlier, you testified before us. I neglected to say at that time, and I told this to Mr. McPherson yesterday at his hearing and I neglected to say at the time Secretary Shultz was testifying before the committee—to indicate the high regard that I had for Mr. McPherson and for yourself. I hope people understand while we may have significant differences on issues, this doesn't mean that we have significant disregard for each other.

The way this democratic system is supposed to work is that people who have very strongly held views can air those views without challenging the good intentions or the good will of people who happen to hold different views. I just, for the record, wanted to make clear that I regard you as a first-rate public servant, a skilled professional, and person who the administration is lucky to have, given your broad expertise in your field.

General, I don't know you as well as I do Mr. Schneider, I have known him longer, but my understanding of you is that you also are a first-rate professional, and care a lot about this country as well, and I just want to welcome you both on a personal level to the committee and get into the record the fact that while we may have some differences, they don't reflect anything except a professional desire on the part of all of us to do what is right for the country under the circumstances in which we are operating.

Let me begin, before you make your opening statements, by simply summarizing where we are at. We are going to be debating on the floor today a reconciliation bill which is attempting to make significant reductions in the Federal deficit. We know we have a lot of obligations, both domestic and international, that great countries meet.

What apparently we have not learned quite so well yet is in pursuance of those obligations, or in pursuit of those obligations, we also need to pay the bills that accrue when we pursue them. And until we agree to do that, it is going to be very difficult for us to justify budget increases for even the most popular programs.

In the President's budget today, versus the 1980 budget, we see that the administration is recommending that we cut virtually every domestic program that is not related to retirement, by drastic amounts. Cancer research, I think it is $68 million; heart research, $61 million; AIDS research, $51 million. Bill has heard these before, and he is probably tired of hearing them, but they are important numbers we have to deal with, and when I look around the House, I know that people are not going to vote for a $2 billion increase in foreign assistance, excluding Ex-Im which we regard as export subsidy, not foreign assistance. I know they are not going to vote for that kind of a bill if the money for that bill has to come out of cutting cancer, heart research and cutting transportation and cutting vocational training and cutting the Coast Guard and a dozen other things that people think are very important.

Just to put it in perspective, while the President is asking us to cut those non-retirement programs essentially in half, from 1981 through his 1987 budget, he is presenting us with a foreign assistance program which in total would take foreign assistance spending out of the jurisdiction of this committee from $6.375 billion in 1981 to $15.474 billion in 1987, an increase of 143 percent.

Development assistance has been increased by 19 percent, from 1981 through 1987. The Economic Support Fund, which represents funding we provide to stabilize the political and economic situation of governments which have very high defense modes is up by 95 percent, and military programs are up to 111 percent, from $3.2 billion in 1981. It is up 111 percent.

MAP grant is up from $110 million, to $1,046 million, which is a 850 percent increase. I would simply ask that people recognize that this isn't the Great Society, this isn't the Great Society budget we are having to vote on these days, and what has happened is that the Congressional Budget Office has estimated that in 1962, as a percentge of our gross national product, we were spending approximately 4.2 percent of our gross national product on domestic discretionary programs. That went to a high of 5.8 percent in 1979 and 1980. It is now down to 4.1 percent of the gross national product, which means that we are devoting a smaller share of our total national income to domestic program needs than we were devoting in 1962, before Lyndon Johnson was ever President, before we ever heard of the Great Society.

So all of that added increment is gone. We are below where we were before we started the Great Society. If the President's budget is tossed in the ash can tomorrow and not passed by the Congress, just leaving us on automatic pilot, given decisions that have already been made, we will take domestic discretionary programs to 3.7 percent of our gross national product by 1991, and if we pass the President's budget, we will take domestic discretionary programs to 2.7 percent of GNP by 1991.

### AFFORDABILITY OF INCREASED FOREIGN ASSISTANCE

And in that context, to suggest that we can somehow afford to increase foreign assistance, especially in the areas for which you will testify, is I think highly unrealistic, to be kind, and so I urge you to recognize two things: Number 1, on the substance of what you say today, I will probably agree with a good deal of it. The problem is that we don't have the ability to give sufficient weight to substantive arguments for any program, domestic or international, when we are under Gramm-Rudman constraints to put the budget deficit first.

I happened to vote against that legislation, but I lost. And we are going to have to live under that.

Secondly, I would just urge you to understand that on another level I am simply trying to point up that the best chance to maximize what you get is to increase the chance for an agreement between the President and the Congress before we have to mark this bill up. Because I honestly don't see, General, and you will conclude that if we produce what I am about to say, you will conclude that is irresponsible. I suspect it is.

But we are not going to have any opportunity to meet our responsibilities in any of these program areas without that kind of political compromise, so you can get about your business of managing your programs without getting stuck in this stuff and so that Bill can do the same and so I can do the same and so we can return to looking at some hard programmatic choices rather than being forced by the context of events to do some things we both think should not be done.

Having said that, let me ask you to proceed and summarize your remarks, make whatever comments you care to to make.

Jerry, did you want to make a short comment?

### VOTE ON CONTRA AID

Mr. LEWIS. I would like to make a brief comment. I have mentioned on a number of occasions within this subcommittee that I am pleased by the pattern we have established of making the Appropriations Foreign Operations Subcommittee a forum for asking questions and building a foundation of understanding. Mr. Chairman, you are successfully laying the foundation for a return once again to a bi-partisan review of our foreign assistance questions.

Because of this to a more bi-partisan approach I want to insert in the record my own personal, intense protest to the full committee markup that which occurred this morning. I am sure it was not your choice, but to have the Full Appropriations Committee take up the question of aid to the Nicaraguan freedom fighters without our subcommittee having received detailed testimony and the most current intelligence information, closing the door if need be and getting the staff out, seems to me to be quite remiss on our part. This would have allowed us to be in a position to make recommendations to the full committee. This move in the Full Appropriations Committee was apparently a reaction to an order from the Speaker to move this aid item forward quickly. Maybe our subcommittee knows all these answers already and this member is just out in the cold somewhere, but in my opinion this procedure was an unacceptable violation of the subcommittee process.

The gentlemen who will present testimony today were unable to provide the kind of background to us regarding this critical problem of Nicaraguan aggression in our own hemisphere. We might as well hang up the Appropriations Committee and close the doors if we are going to operate in that fashion. We didn't even have significant debate in the full committee. Everybody assumed it was unnecessary. But, most important, if we are going to spend the hours that I know we all spend on these very critical world matters and not have our subcommittee even discuss the items before the full committee, I wonder if we are really doing our jobs.

Mr. OBEY. Well, Mr. Lewis, if I could respond, I will have to defend the Leadership on this.

Mr. LEWIS. Certainly.

Mr. OBEY. Let me state, first of all, the process requires an absolute up or down vote, no amendments. Again, I didn't vote for the Nicaragua legislation last year. But the process requires the committees, on an expedited procedure pushed through the Congress by the administration and supporters, the process requires that we act within 15 days, I believe, is the number. Is it 15 or ten? I think I just got two different answers back here, I am not sure.

This committee is one of four committees that has—the Appropriations Committee is one of four committees which has jurisdiction. We are one of two subcommittees which has jurisdiction within the Appropriations Committee, and as was pointed out this morning in the committee—there are hours ad nauseum for debate on the House floor, I believe nine hours, or ten hours, required under the process. I don't think it is correct to say that this subcommittee has not discussed the Contadora package. I thought we had discussed it quite extensively with the Secretary of State, and I don't know who is more qualified to discuss it than he is.

This committee has jurisdiction only over the "humanitarian assistance." I asked questions about what had been provided by way of Contra assistance out of the money we actually provided last year, and the response that I got was significantly less than what we provided had been actually delivered, but the Secretary indicated that ample and adequate testimony had been given on that fact all over Capitol Hill. He said that, I did not.

And because we had two subcommittees which had jurisdiction, and ours being peripheral at best in comparison to the Defense Subcommittee, the committee made the decision to move ahead. It was not my decision, and I certainly was fully prepared to debate it as a practical matter.

The sponsor of the resolution to improve the Contra funds, Congressman Murtha, was recruited by the administration to sponsor the administration's position in support of the Contra aid, came to me and asked me personally to accede to his request not to have extensive discussion in the Appropriations Committee, because, in his words, everybody knows what is in it, and everybody knows where they are on it, and since we are going to debate it, we ought not to proceed this morning.

### SUBCOMMITTEE DEBATE

I had fully intended to debate it until Congressman McDade and Murtha came to Jimmy and to me and said "Let's knock it off and just vote it out." So if you want to raise an objection to the fact there was not extended debate from the committee this morning, raise it with your own ranking member on the Defense Subcommittee, with Mr. Murtha, your principal pony on the Democratic side, because they were the fellows who asked us to do it that way.

Mr. LEWIS. Mr. Chairman, I believe this is the Subcommittee on Foreign Operations, which has to do with foreign assistance and foreign military sales. I suppose the Democratic leadership gave us foreign military sales because otherwise they figured there was no way to get a foreign assistance package out of this place, but it does give us some significant jurisdiction.

It seems to me that there are some critical questions in which we ought to be coming together not as Republicans or Democrats but as representatives of the citizens of the United States.

Mr. OBEY. Why didn't the gentleman ask it when the Secretary was here?

Mr. LEWIS. Mr. Chairman, the Secretary was here to talk about the world. The issue I am discussing at this moment is Nicaragua, $100 million of appropriations which deserves ten hours of this subcommittee's time. That is really the point. The way the subcommittees are structured, you have the votes to do what you want. But to give away that kind of authority and responsibility to others is wrong. Maybe it is just that I come from San Bernardino, California, but it seems to me we have given away to much of our subcommittee's jurisdiction.

Mr. OBEY. You can wonder all you want. It was the chairman who spent more than half an hour asking questions of the Secretary on the Nicaraguan situation. I don't recall if you asked a question or not. I know the chair fulfilled his responsibilities. I had no request from a single member on your side of the aisle to provide an additional hearing. Everyone has the hearing schedule, at least your staffs have it. If you have an objection, you have an obligation to tell the chairman beforehand, not after.

Mr. LEWIS. Mr. Chairman, I am not here to defend the administration. That is not my purpose. The process is at stake here. I would guess there is current intelligence information which would be very helpful in considering the pros and cons of a matter like this in a non-partisan way. If, as the result of our lack of action, we end up having a vote that leads to the support of a Communist country being firmly established in our hemisphere, I am sure that some will live to regret it.

Mr. OBEY. I would simply point out to the gentleman, I am not the chairman of the full committee. This subcommittee didn't give up anything. The matter was never referred to the subcommittee, as the gentleman well knows, it was handled in full committee because there was competing jurisdiction among subcommittees, and as far as I am concerned, that is all right with me. I agreed to it because I thought it was a responsible thing to do. I have asked my questions on Nicaragua of the Secretary. If you have any additional questions you want to ask of these gentlemen on Nicaragua, be my guest. If you suggest there ought to be additional hearings in addition to the two we have had prior to any vote on the House floor, it was your obligation to ask the chairman before the vote came. It isn't mine to anticipate what is in your mind.

Mr. LEWIS. Mr. Chairman, I appreciate your yielding me the time.

### THE SECURITY ASSISTANCE PROGRAM

Mr. SCHNEIDER. Thank you, Mr. Chairman..

Let me say I appreciate the generous remarks you have made about me, and I am confident were it not for Gramm-Rudman, your remarks would constitute a basis for me getting a raise.

Mr. OBEY. I don't think you could get a raise downtown on the basis of what I recommend.

If I can denounce you and help you in any way, let me know [laughter].

Mr. SCHNEIDER. Before getting into the summary of my remarks, Mr. Chairman, I would like to make one brief remark that is, perhaps, somewhat philosophical about the foreign assistance program, but I think it reflects on a discussion we have had many times about the role of military assistance in the larger complex of our foreign assistance. We have had this discussion frequently about the mix, and you have alluded in your opening remarks to the growth rates of the military assistance in relation to other dimensions of the foreign assistance program.

I would like to make the general point that the question of providing security assistance or military aid to friendly countries is something that the United States is in a unique position to do, and it happens that the foreign assistance program is a unique vehicle for delivering that assistance.

On the other hand, economic assistance is available through many channels, some of which are in the foreign assistance program, such as development assistance and economic support funds, and the U.S. contribution to multilateral financial institutions.

But it is possible for many friendly countries to get economic assistance from other countries or other financial institutions or other appropriation acts by the Congress, such as the Public Law 480 appropriations, but security assistance is something we are in a unique position to do, and assist countries with security, because they have no alternative.

So I think, looking at the question of the mix between economic and military assistance, it is really helpful to look at the whole picture. I don't want to dwell on it now, but we have had a particularly cooperative attitude from the Japanese on the subject of providing economic assistance in areas outside of their traditional zone of interest. So I think that we should think about this in a broader way, to put the security assistance dimension in perspective.

## UNDER SECRETARY SCHNEIDER'S STATEMENT

Mr. Chairman, I have a longer version of my remarks which, with the chair's permission, I would propose putting in the record, and I would simply provide a summary.

The President's budget for the coming fiscal year reflects painstaking analysis and many hard choices. I welcome the chance to discuss with you today our proposals for security assistance in fiscal year 1987.

Within an overall budget package consistent with Gramm-Rudman-Hollings deficit reduction limits, the program we propose is responsive to the political, economic and military challenges we face. It is a balanced effort to utilize security assistance as an effective instrument of U.S. foreign and defense policies.

Security assistance is an essential part of the United States' effort to guarantee its own national security. It is an extenson of the resources we devote to our own forces, part of our role as a major leader of the free world.

Since World War II, our security assistance effort has evolved and diversified to meet changing world conditions, reflecting a cooperative effort between succeeding administrations and Congresses. Over the past five years, Congressional support for the expansion of program levels and changes to basic legislation have provided a basis for dealing more effectively with current and emerging problems.

We have made progress. But the job is far from completed. Many challenges and opportunities lie before us. We again seek the cooperation and support of the Congress in assuring that the United States is able to do what must be done.

## FY 1987 REQUEST

Approximately half of our total fiscal year 1987 request is directed to encouraging peace in the Middle East, in particular a just and comprehensive peace between Israel and its Arab neighbors. A total of $5.3 billion is proposed toward this important goal. $3 billion in "forgiven" Foreign Military Sales credits and Economic Support Fund grant financing will help assure Israel's continued military preparedness and economic stability. A $2.1 billion package will support Egypt's continuing commitment to its 1979 peace treaty with Israel. The more modest levels proposed for Jordan are essential to that country's ability to implement its commitment to the peace process.

Strengthening cooperative security arrangements with allies and friends at strategic points around the world is a cornerstone of our foreign and defense policy. This year's budget devotes some $2.8 billion toward this objective. The largest such programs are those with NATO partners: Spain, Portugal, Greece and Turkey. These programs enhance allies' ability to contribute to NATO's proven strategy of deterrence and defense against the threat of Soviet aggression. They also reflect close and specialized arrangements for bilateral cooperation, represented by significant U.S. military bases and installations.

In the Pacific, our program supports similar base arrangements with the Republic of the Philippines, a valued friend and ally. The new Government of the Philippines will need our continued help and support to deal with deep-seated economic and social problems and an entrenched communist insurgency. In a number of North and East African countries, and Panama, there is also a real, if not always explicit, linkage between our programs and the facilities these countries make available which enhance the strategic reach of U.S. forces.

Free and friendly nations in many areas of the world are facing aggression, the threat of aggression or externally supported insurgency and subversion. These conditions are a challenge to fundamental U.S. interests. Our program proposals will continue to assist front-line countries, such as Korea, Thailand and Pakistan in meeting such challenges.

El Salvador's efforts to deal with externally supported guerrilla and terrorist activities and to address underlying causes of unrest directly depend on our programs. Our help in the past four years has allowed the Salvadoran Government to gain the military initiative and to make an impressive start on permanent democratic institutions. We must keep up the momentum. Our proposals will encourage similar reforms in Honduras and strengthen both Honduras and Costa Rica in the face of a heavily armed and hostile Sandinista regime in Nicaragua. U.S. assistance plays a key role in sustaining the self-defense capabilities of Tunisia and Chad against continuing threats from neighboring Libya.

The broad goal of U.S. security assistance in a number of recipient countries is regional stability. These include Indonesia, Burma, our neighbors and friends of South America and the Caribbean and countries of sub-Saharan Africa. Country and regional programs attempt to address structural economic problems and, where appropriate, provide some help in military modernization.

In many other countries, especially within the developing world, our security assistance relationship is essentially limited to activities under the International Military Education and Training program. This cost-effective vehicle enhances military skills and professionalism, exposes a key segment of foreign societies to American strategic, political and humanitarian views, and forces ties that can provide access to future leaders.

## FMS RECIPIENTS' DEBT BURDEN

Legislative changes in recent years have given us greater flexibility to tailor programs to country situations and policy goals. Among these innovations are the "forgiven" FMS credits for Israel and Egypt and the ability to provide concessional rate credit. The concessional alternative meets a genuine need, but the availability fell short of that need in fiscal year 1986. I strongly urge the subcommittee to give favorable consideration to our request for an increase in the concessional ceiling for fiscal year 1987.

We share the concern of many in Congress with respect to the foreign debt burden on many of our major program participants. We are monitoring the country impact of our loans and are undertaking a more comprehensive analysis of the problem and possible solutions. We will share with you some of the insights and conclusions that emerge from this effort.

### SDAF

The Special Defense Acquisition Fund (SDAF) is becoming an effective mechanism for providing timely support of valid defense requirements. We are now able to shorten delivery lead time and introduce a revolving fund aspect into SDAF. What we now need most is a two-year obligation authority to synchronize more closely SDAF procurements with those of our military departments. We are also requesting $350 million in obligation authority, which can be supported with the capital and receipts from SDAF sales.

### SHORTFALLS

I have cited with satisfaction the cooperation between the administration and Congress, including specifically yourself, Mr. Chairman, on the last five years' security assistance agenda. I must, however, underscore with equal frankness that the fiscal year 1986 legislation left serious shortfalls for many of our major programs. Earmarking, ceilings and restrictive provisos further complicate the problem posed by funding reductions, creating legal and systemic rigidities to complicate already difficult tradeoffs and hamper adequate and timely responses to unforeseen needs and opportunities.

If we are to utilize security assistance as an effective policy tool, we must have both adequate resources and a sufficiently flexible legislative mandate.

Mr. Chairman, that completes my prepared remarks. I will be happy to respond to your questions.

[The statement of William Schneider, Jr. follows:]

Statement by

William Schneider Jr.,

Under Secretary of State

for

Security Assistance, Science and Technology

before the

Subcommittee on Foreign Operations

Committee on Appropriations

U.S. House of Representatives

March 6, 1986

Mr. Chairman, Members of the Subcommittee on Foreign Operations:

The President's budget for the coming fiscal year reflects much painstaking analysis of the competing demands on limited national resources. It reflects rigorous sifting of priorities. And, it reflects many hard choices.

As the Congress begins its equally painstaking and thoughtful consideration of this budget request, I welcome the chance to meet with you today to discuss our proposals for Security Assistance in FY 1987.

Within an overall budget package that we believe is fully consistent with Gramm-Rudman Hollings deficit reduction limitations, the Security Assistance Program levels and composition we are presenting for your consideration are responsive to the political, economic and military challenges we face. Our proposals are targeted to defined needs and goals.

In this year's supporting documentation, we have made this linkage more explicit than in years past, and we have tried to meet some of the expressed desires of committees for expanded program and background data.

The proposed Security Assistance program is a comprehensive, and balanced effort to utilize security assistance as an effective instrument of United States foreign and defense policies. Significant reductions in the program -- whether by direct Congressional action or by the automatic cuts under the existing deficit reduction legislation -- will seriously cripple our efforts to meet challenges to our vital interests around the globe.

By definition, "Security Assistance" benefits other countries. It helps other countries become stronger and safer. Security assistance is also an essential part of the United States' effort to guarantee its own national security. It is an extension of the resources we devote to our own defense forces, and derives inescapably from our role as a superpower and the leader of the free world. It serves our "bottom line" national interest in the survival, integrity and prosperity of our own nation and society. It is part of the search for a world environment in which there is respect for the rights both of nations and of individuals.

In the forty years since World War II, our Security Assistance effort has evolved, has expanded and has diversified to meet changing world conditions. This process has been a cooperative effort between succeeding Administrations and Congresses. The Executive and Legislative Branches recognized that strong U.S. action was required to help rebuild and rearm the democracies of the West in the immediate aftermath of a global conflict and under the growing shadow of Communist aggression and subversion. In the face of an increased Soviet threat in the post-war era and the emergence of other challenges to world order, there has been essential agreement within our government on the need to maintain and refine mechanisms for aid and cooperation with friendly countries. Over the last five years in particular, Congressional support for the expansion of program levels and the legislative changes to the Foreign Assistance and Arms Export Control Acts have provided a basis for dealing more effectively with current and emerging problems.

We have been able to maintain and expand cooperative and supportive relationships with allies and friends around the World; to meet our commitments to the security of Israel and to the search for peace and stability in the volatile Middle East; to strengthen the confidence and capabilities of nations facing aggression and insurgencies waged or supported by the Soviet Union and its surrogates; to help deter or contain regional conflicts; and to encourage the development of democratic institutions, economic growth and policies responsive to human needs.

We have made progress. But the job is far from completed. A spectrum of challenges and opportunities lie before us as we look ahead to FY 1987 and into the next decade. The Administration's budget proposals represent the response we must make to protect our own vital national interests. The program elements are specifically tailored to these interests. And we again seek the cooperation and support of the Congress in assuring that the United States is able to do what must be done.

Approximately half of our total FY 1987 Security Assistance request is directed to encouraging the process toward peace in the Middle East. The proposed U.S. programs for countries of this strategic and unsettled area will facilitate economic development, encourage political moderation and promote regional stability. In particular, our security assistance relationships will continue to be supportive of our diplomatic efforts to secure a just and comprehensive peace between Israel and its Arab neighbors. Our programs are tangible signs of the United States' determination to honor its commitments, and are a vital factor in efforts to curb Soviet influence in the area and to deter aggression, subversion and state-supported terrorism.

A total of $5.3 billion in Economic Support Funds, Foreign Military Sales financing and International Military Training and Education Program grants is proposed toward this important goal.

$3 billion in "forgiven" Foreign Military Sales credits and grant balance of payment support from the Economic Support Fund will help assure Israel's continued military preparedness and promote the country's economic stability. A $2.1 billion total Security Assistance package for Egypt will support that country's continuing commitment to its 1979 peace treaty with Israel. This "forgiven" FMS and ESF grant financing is designed to help modernize the Egyptian military and support needed economic reforms.

For Jordan, we are proposing relatively modest FMS credit and ESF levels focused on sustaining current readiness levels without major force improvements and on supporting ongoing development projects. Continuing U.S. assistance is essential to Jordan's ability to implement its commitment to the peace process. The remaining proposals directly supportive of Middle East peace will finance small-scale activities -- including humanitarian and reconstruction efforts -- in war-torn Lebanon, as well as economic and social development efforts throughout the area under the umbrella of the Middle East Regional Fund.

Strengthening coalition defense capabilities and concrete cooperative security arrangements with allies and friends in strategic points around the world is a cornerstone of our foreign and defense policy. This year's budget devotes some $2.8 billion to this essential goal. The largest programs under this rubric are those with partners in the North Atlantic Alliance: Spain, Portugal, Greece and Turkey. These strategically important nations are formally committed to collective security under the North Atlantic Treaty; three are participants in NATO's integrated military structure. Our programs enhance their ability to contribute to the Alliance's strategy of deterrence and defense against the threat of Soviet aggression -- a strategy which has successfully served the cause of peace for forty years and in which security assistance has played a pivotal role. In more specific terms, the programs will provide financing for the procurement of major U.S. weapons systems, notably including the planned acquisition by Turkey and Greece of F-16 aircraft and Spain's ongoing purchase of F-18s.

Our programs in these four NATO nations also reflect close and specialized arrangements for bilateral cooperation. They are countries in which we maintain significant U.S. military bases and other installations. These facilities not only contribute to U.S. ability to help defend Western Europe but are an essential element in our global defense posture.

In the Pacific, our proposed programs support the equally important base arrangements we have with the Republic of the Philippines. The Philippine nation is an old friend and ally. The strategic, historical and human ties that bind us together are strong. We have just been reminded of how real these ties are, as we have witnessed and admired the courage of the Philippine people and their devotion to democratic values. The new Government of the Philippines will need our continued help and support as it sets out to deal with deep-seated economic and social problems and the serious threat to internal security and democratic institutions posed by an entrenched Communist insurgency.

In Djibouti, Kenya, Liberia, Morocco, Oman, Panama, Somalia and Sudan, our proposed programs of security assistance are tangible evidence of a U.S. commitment to the integrity and security of these countries. For their part, these countries demonstrate that they share with us important international security goals by making available a range of facilities to enhance the mobility and strategic reach of U.S. forces. The linkage between the contributions on each side may not always be explicit, but it is real and understood.

In many areas of the world, free and friendly nations are facing active external aggression, the threat of such aggression, or externally supported insurgency or subversion. These conditions not only put in jeopardy the security of the individual countries, but also undermine the security of neighboring areas. They are a challenge to fundamental U.S. interests.

The FY 1987 program proposals we have submitted to the Congress will help deter North Korean aggression against the Republic of Korea and strengthen Thailand's ability to deter and counter the spread of Vietnamese aggressive activities across the Thai border with Cambodia. The $591 million combined ESF, FMS and IMET program we are proposing for Pakistan will support that strategically located country in its continuing opposition to the Soviet invasion and occupation of Afghanistan, encourage internal economic and political development and help provide the self-confidence needed to make progress in the nuclear non-proliferation area.

Closer to home, in Central America, our programs are essential. El Salvador's efforts to deal with an externally supported guerrilla and terrorist threat and to press forward with political, economic and social reforms to meet the underlying causes of unrest directly depend on these programs. Our programs over the past four years have allowed the Salvadorans to gain the military initiative and make an enormously impressive start towards building permanent democratic institutions. Reducing or curtailing this program now would mean the abandonment of our considerable investment in resources and some blood. Worse, it would make a mockery of the enormous sacrifices the Salvadorans have made to build a future in a free society. Our proposals will promote similar economic and institutional reforms in Honduras and sustain the ability of both

Honduras and Costa Rica to meet the threat posed by the excessive and expanding military forces of the Sandinista regime in Nicaragua.

U.S. assistance plays a key role in sustaining the self defense capabilities of Tunisia, a voice for moderation in the Arab world. This friendly country faces a continuing threat from the aggressive policies of its neighbor, Libya. Similarly, our logistics support programs for Chad will complement the direct combat support efforts of France and help strengthen the hand and the will of the Chadian Government against the threat of renewed attacks by Libyan-supported rebels. Our proposed program for the Yemen Arab Republic will improve the defensive posture of this buffer state between a Marxist and newly unstable and radicalized South Yemen and moderate nations of the Red Sea littoral. It will help balance Soviet influence in that country and region.

In a large number of recipient countries the broad goal of our security assistance can be categorized as "regional stability." The programs will help these countries to develop a credible capability for self defense and at the same time encourage the implementation of broad reforms to address the imbalances and injustices which breed internal unrest and international tensions.

Among our neighbors and friends of the Caribbean, for example, our proposed programs will support the democratic government of the Dominican Republic as it pursues the difficult austerity measures of a comprehensive economic adjustment program. They will play a similar supporting role in Jamaica's ongoing economic reform efforts and help sustain the Jamaica Defense Force as a major player in Caribbean collective security efforts. In Grenada, and the six other mini-states of the Eastern Caribbean, we propose a carefully tailored package of ESF, MAP and IMET that will promote development and help these islands meet minimum defense requirement to deter internal and external threats.

Complementing our other programs in Central America, we are proposing both military and economic assistance to Guatemala. We recognize that the military component is controversial. However, in the light of experience in other countries, we believe that such assistance, channeled through civilian authorities, can do much to help consolidate respect for democratic principles and institutions and contribute overall to the stability of the region.

Our foreign military sales programs for Indonesia and Malaysia support the military modernization efforts of those strategically located countries and encourages their continuing roles as moderate and constructive participants in the non-aligned movement. Our proposed assistance to Burma and the Andean countries of South America will strengthen the respective governments in their efforts both to combat insurgencies and control narcotics production and trafficking.

Our programs in many countries of sub-Saharan Africa seek to encourage regional stability primarily through economic and social development. These country-specific efforts will be complemented by the Africa Economic Policy Reform Program which addresses structural economic problems by providing fast-disbursing ESF funds as incentives to growth-oriented changes in policy, and it promotes better coordination with other donors of aid to the continent. The Southern Africa Regional Program includes economic and developmental assistance to those countries who contribute to constructive solutions to the problems of southern Africa and assistance in education and other areas for South Africans who suffer under apartheid.

In many countries, especially those within the developing world, our security assistance relationship is essentially limited to relatively small-scale activities under the International Military Education and Training, or IMET, Program. This very cost-effective vehicle produces immediate gains in enhanced military skills and professionalism in friendly participating countries. It exposes a key segment of foreign societies to U.S. strategic thinking and to American political and humanitarian values. Most importantly, it forges lasting personal ties that can provide access to future leaders and facilitate a range of constructive bilateral relations through years to come.

At this point, Mr. Chairman, I would like to discuss briefly a few of the more important Security Assistance mechanisms that allow us to maximize the effectiveness of our programs in a way that does not cause longterm economic suffering to our security partners.

As I noted earlier, the legislative modifications of recent years have provided us with much greater flexibility to tailor our programs to specific country situations and to the broad policy goals we are pursuing. Within the funded programs, we seek where appropriate a prudent and effective degree of concessionality in the mix of grants and loans. Notable among the innovations that are being used to good effect are the "forgiven" FMS credits for Israel and Egypt, and the ability to provide a certain amount of concessional rate credit to those countries who, to one degree or another, can pay their own way on major defense acquisitions but cannot undertake the credit burden represented by Treasury rates of interest. Experience has now shown that the concessional alternative meets a genuine need, but the availability of this type of credit fell short of that need in FY 1986. Our projections indicate that requirements for concessional credit will grow rather than diminish in the coming year, and I strongly urge the Subcommittee to give favorable consideration to our request for an increase in the concessional ceiling for FY 1987.

We share the concern of many in Congress that our security assistance loans not add unduly to the significant foreign debt burden already being sustained by many of our major program participants. It is, indeed, this concern that lies behind our request for expanded authority for concessional lending, and which has influenced our higher request levels for the grant Military Assistance Program. We are monitoring the country impact of Security Assistance loans on a continuing basis, and this impact is in the forefront of the various considerations we take into account in formulating country program proposals. In addition, we are undertaking a more comprehensive analysis of the foreign debt problem and possible solutions. Within the coming months, we expect to share with you some of the insights and conclusions that emerge from this effort.

It is clear both to us, and our foreign partners, that the Special Defense Acquisition Fund (SDAF) is becoming an effective mechanism for providing timely support of valid defense requirements. As SDAF items are now beginning to come off the production line, we are able to shorten delivery lead time and introduce a real revolving aspect into SDAF. To ensure that this trend continues we need most of all a two-year obligational authority so that we may better synchronize SDAF procurements with those of our military departments. In addition we are requesting $350 million in obligation authority for FY 1987, a level that can be supported with the capital and receipts from SDAF sales -- without appropriations.

At the outset of these remarks I cited with satisfaction the constructive interaction of the Administration and Congress on the last five years' security assistance agenda and the resulting expansion and improvements in the program. This characterization is an accurate one in terms of the overall picture and the prevailing trend line. I must, however, underscore with equal frankness that the FY 1986 legislation produced serious shortfalls in funding for many of our major programs.

Earmarking, ceilings and restrictive provisos further complicate the problem posed by program reductions. While each of these has its persuasive rationale, and often responds to genuine concerns which the Administration shares with the Congress, the cumulative effect is a marked increase in the legal and systemic rigidities to be faced in making the difficult, but necessary tradeoffs of competing demands, in responding to unforeseen needs and in capitalizing on short-lived opportunities.

If we are to continue to utilize security assistance as a highly effective tool of U.S. foreign and defense policy -- and it is imperative that we do -- we must not only have adequate resources, but a legislative mandate that is sufficiently flexible to allow efficient management of these resources to meet policy imperatives.

Mr. Chairman, Members of the Subcommittee, our Security Assistance program for Fiscal Year 1987 was developed in full recognition of the funding constraints that face us all. But, it is a strong and assertive U.S. response to the serious and complex needs that must be addressed; we cannot walk away from our responsibilities. Like the defense budget, Security Assistance is an investment in the preservation of the freedoms and well being of our nation and people. It encourages and makes possible other countries' contributions of human and material resources to complement U.S. efforts in the pursuit of shared goals.

The problems and threats that Security Assistance addresses are real and cannot be ignored. We must build on past successes and be prepared to meet upcoming challenges. Failure to move ahead steadily means losing ground, and would have serious consequences. I strongly urge the support of this subcommittee, as well as that of your colleagues in the Congress, for our program proposals.

Mr. Chairman, that completes my prepared remarks. I will be happy to respond to your questions and to those of the other members of the Subcommittee. I hope that we will be able to work together over the next several months to craft a Security Assistance program for FY 1987 that is responsive both to fiscal and to national security policies.

## TESTIMONY OF GENERAL GAST

Mr. Obey. General Gast, why don't you proceed, too.

General Gast. If I may have my formal statement entered into the record and briefly summarize, I would ask copies of the charts——

Mr. Obey. General, could I ask you to suspend for just a second. We have a little housekeeping matter we have to take care of.

Mr. McHugh. I would like to move at this point the Foreign Operations Subcommittee hearing this afternoon be closed as necessary because of the classified nature of the discussion that will be before us at that time.

Mr. Obey. Any questions?

Mr. Peel. Mr. Obey.

Mr. Obey. Aye.

Mr. Peel. Mr. Yates.

(No response.)

Mr. Peel. Mr. McHugh.

Mr. McHugh. Aye.

Mr. Peel. Mr. Lehman.

(No response.)

Mr. Peel. Mr. Wilson.

Mr. Wilson. Aye.

Mr. Peel. Mr. Dixon.

(No response.)

Mr. Peel. Mr. Gray.

(No response.)

Mr. Peel. Mr. Mrazek.

Mr. Mrazek. Aye.

Mr. Peel. Mr. Kemp.

Aye.

Mr. Peel. Mr.Edwards.

(No response.)

Mr. Peel. Mr. Lewis.

Aye.

Mr. Peel. Mr. Porter.

Mr. Porter. Aye.

Mr. Obey. We will hold it open until the other members come. General, please proceed.

[Slide follows:]

# SECURITY ASSISTANCE

— COST EFFECTIVE CONTRIBUTION TO NATIONAL DEFENSE —

## DETERRENCE

- DEFENSE COOPERATION - - BASE RIGHTS
- MIDDLE EAST PEACE
- ISOLATING RADICAL STATES

## CONFLICTS

- CONTAINING AGGRESSION AT LOWEST LEVEL
- COMBATTING INSURGENCIES
- COPING WITH TERRORISM

General **Gast**. I also welcome the opportunity of appearing before your subcommittee and the opportunity to make what wil be a very brief presentation, representing the Department of Defense for the President's proposed budget request. I take it from your comments, they are not sensitive issues, but we think it would be worthwhile to put it in the context of where we have been and where we are, security assistance being a most cost effective contribution for deterrence to defense cooperation, as well as to stem and contain conflicts.

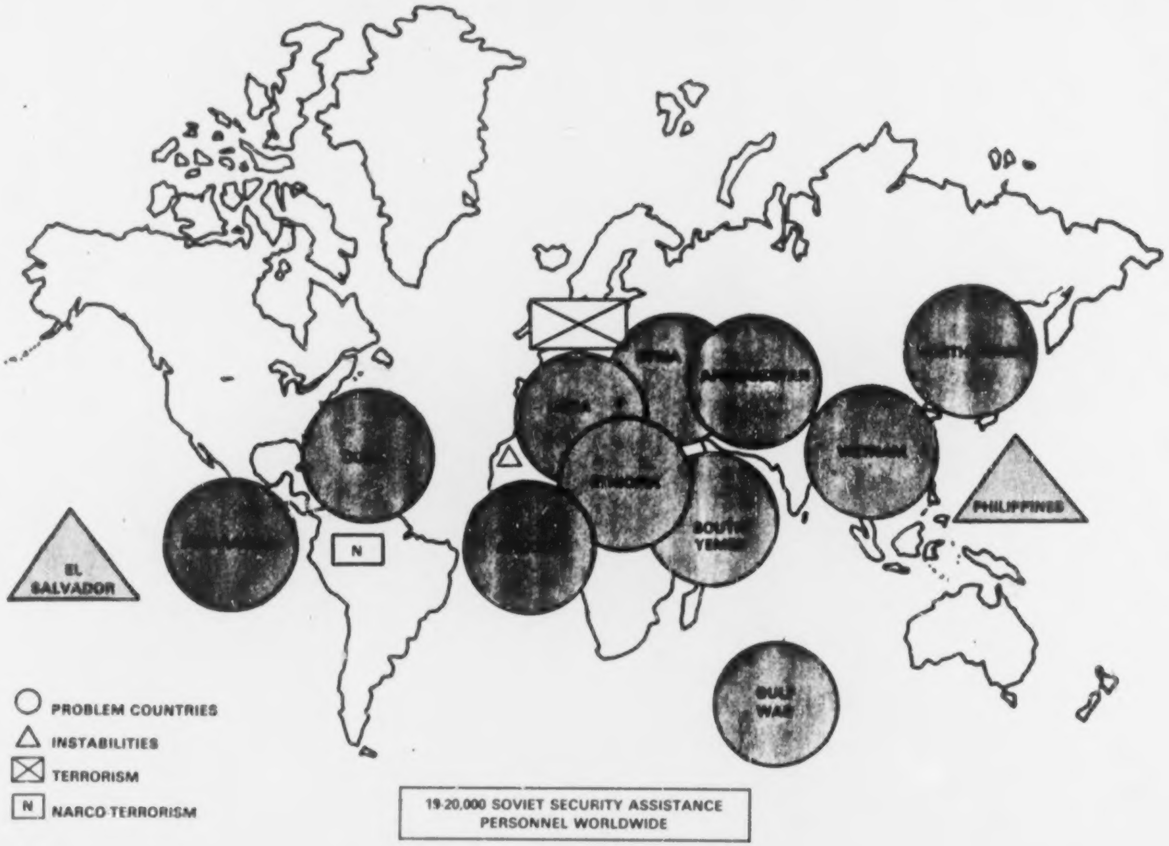
### THE WORLD SITUATION

It is always useful, we believe, to review the situation around the world and note many of the countries that are troublemakers.

[Slide follows:]

#2

# MAJOR CHALLENGES TO THE PEACE


EL SALVADOR
N
SOUTH YEMEN
PHILIPPINES
GULF WAR
○ PROBLEM COUNTRIES
△ INSTABILITIES
☒ TERRORISM
N NARCO-TERRORISM

19-20,000 SOVIET SECURITY ASSISTANCE
PERSONNEL WORLDWIDE

OFFSET
CAMERA COPY

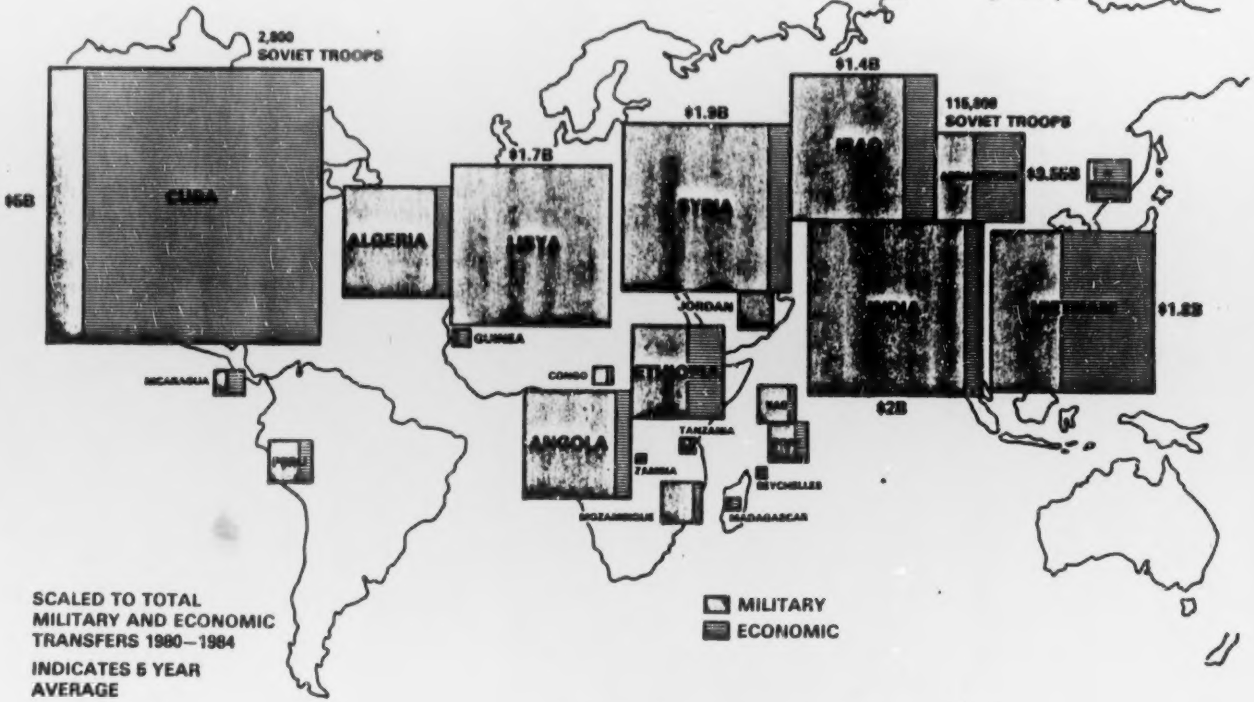
It is well known here in East Asia beginning with North Korea through Vietnam the impact the troublemakers in this region, and it has spilled over perhaps, into the Philippines in which case we need to help them when they are ready to be helped, continuing much in the way we are working with them and have been working with them.

I note Afghanistan and the problems and pressures it brings against Pakistan as well as South Yemen, Syria, Libya, and very radical Ethiopia—onto Angola, Cuba, Nicaragua and the instability within El Salvador. Over-arching all of this is a terrorist threat, and, of course, the narco-terrorist problem in the Andean region.

[Slide follows:]

#3

# SOVIET MILITARY SALES/ASSISTANCE AND ECONOMIC ASSISTANCE*
(1980—1984)


2,800
SOVIET TROOPS
$6B
CUBA
NICARAGUA
PERU
ALGERIA
$1.7B
LIBYA
GUINEA
$1.9B
SYRIA
JORDAN
$1.4B
IRAQ
115,000
SOVIET TROOPS
$3.55B
INDIA
$2B
$1.8B
ETHIOPIA
CONGO
ANGOLA
TANZANIA
ZAMBIA
MOZAMBIQUE
SEYCHELLES
MADAGASCAR
SCALED TO TOTAL
MILITARY AND ECONOMIC
TRANSFERS 1980—1984
INDICATES 5 YEAR
AVERAGE
MILITARY
ECONOMIC

*APPROXIMATELY 20,000 SOVIET MILITARY ADVISORS (NOT INCLUDING COMBAT TROOPS)

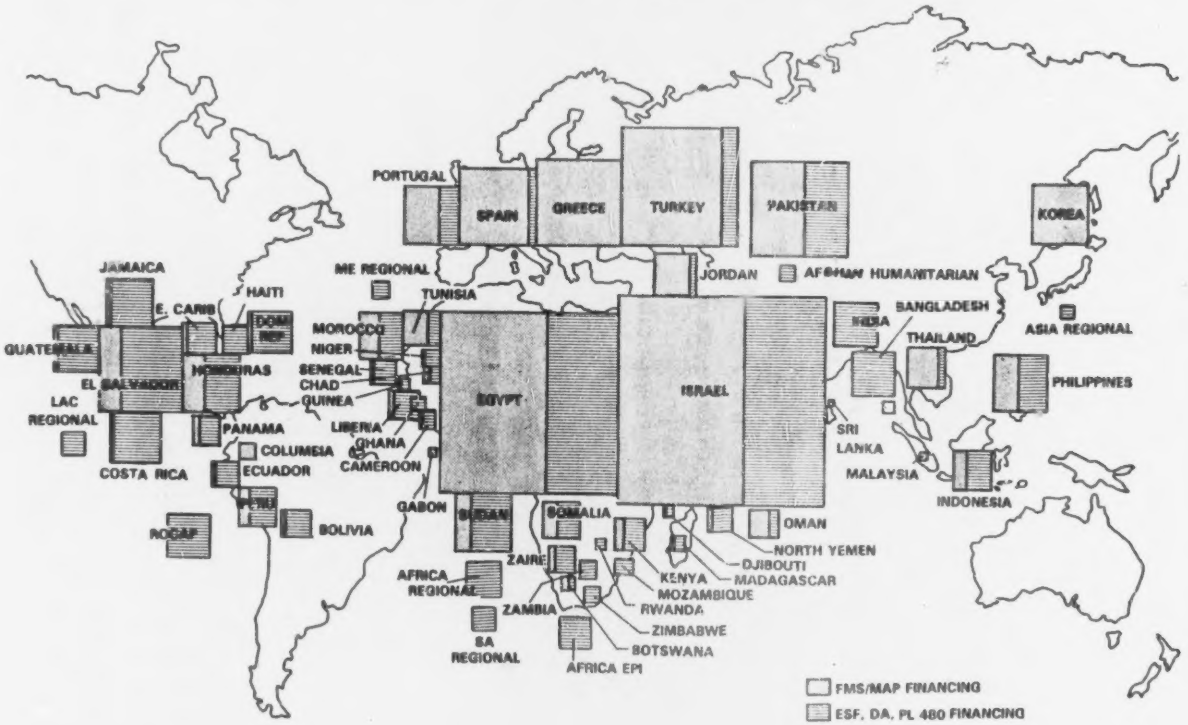
OFFSET
CAMERA COPY

It is constructive to note how the Soviets do it. These charts are scaled here equally in terms of an average over the last five years, and you will note, for example, within Syria, Soviet assistance, is $1.9 billion and within Cuba, $5 billion a year. You will also note the red, as shown here, is military, and the green is economic. The Soviets do not have a Congress, do not have a consensus, and, therefore, they do not have the rationale of the full government in support of the program. There is no indication that they are going to reduce this amount. They have finished several five-year plans, we believe they will provide even larger sums.

There is a striking correlation between the earlier chart that I showed you, with the red dots, and this one here.

[Slide follows:]

# FY87 REQUEST: ECONOMIC & MILITARY PROGRAMS
(scaled to program size)


PORTUGAL
SPAIN
GREECE
TURKEY
PAKISTAN
KOREA
ME REGIONAL
JORDAN
AFGHAN HUMANITARIAN
JAMAICA
HAITI
E. CARIB
DOM REP
GUATEMALA
EL SALVADOR
HONDURAS
LAC REGIONAL
PANAMA
COSTA RICA
COLUMBIA
ECUADOR
PERU
BOLIVIA
ROCAP
TUNISIA
MOROCCO
NIGER
SENEGAL
CHAD
GUINEA
LIBERIA
GHANA
CAMEROON
GABON
EGYPT
ISRAEL
SUDAN
SOMALIA
ZAIRE
AFRICA REGIONAL
ZAMBIA
SA REGIONAL
AFRICA EPI
BOTSWANA
ZIMBABWE
RWANDA
MOZAMBIQUE
KENYA
MADAGASCAR
DJIBOUTI
NORTH YEMEN
OMAN
INDIA
BANGLADESH
SRI LANKA
THAILAND
MALAYSIA
INDONESIA
PHILIPPINES
ASIA REGIONAL
FMS/MAP FINANCING
ESF, DA, PL 480 FINANCING

NOT ALL COUNTRIES SHOWN

OFFSET
CAMERA COPY

Over the years we have been working with the Congress. We do things differently from the Soviets.

We work with the countries not only to support them against this Soviet threat, but also our mix of economic and military is substantially different from the Soviets. We recognize that nations need economic help as well as military assistance. The red here is FMS and MAP financing, and the green is economic.

We, and the Carlucci Commission consider economic support funds as economic assistance and the ratio has been roughly 60/40 economic to military throughout the years and remains so at this time. It is also interesting to indicate that, the seven countries in this Middle East region are about 80 percent of the budget request and have been traditionally, so other, frontline states must take a lesser amount. Also where countries are able to pay like in Europe, we have a higher military portion than economic particularly with those countries that are frontline. I will come back to talk about Turkey later.

In the rest of this portion of the world, there is about ten percent of the budget in this area, and only about seven or eight percent in this area, largely in economic assistance in those countries that need it, in the sub-Sahara, as well as in our own hemisphere.

Moving on to the Philippines, we have an adequate mix here, which is yet to be determined, and in Korea, of course, it is all military assistance since they have a strong economy.

[Slide follows:]

#5

# PURSUIT OF OBJECTIVES: THE RECORD

| | | | | |
|---|---|---|---|---|
| MEDITERRANEAN LITTORAL | QADDAFI DETERRED | NATO BASE RIGHTS RENEWED | WESTERN SAHARA MANAGED | CHAD SUPPORTED |
| MIDEAST | ▨ SYRIA CONSTRAINED | ENHANCED STRATEGIC DIALOGUES | ▨ EGYPT-ISRAEL PEACE PRESERVED | |
| SWA | GULF WAR CONTAINED | ACCESS PURSUED | ▨ STABILITY ON HORN | PAKISTAN SUPPORTED |
| EAST ASIA PACIFIC | SUPPORT TO THAIS | ▨ STABILITY OF THE KOREAS | PHILIPPINE SUPPORT-PLAN DEVELOPED | |
| CENTRAL AMERICA | DEMOCRACY SUPPORTED IN EL SALVADOR | NICARAGUA ISOLATED | HONDURAS AND COSTA RICA STRENGTHENED | |
| WORLDWIDE | SOVIET CLIENTS CHALLENGED | ALTERNATIVE TO SOVIETS OFFERED | SOVIET AGGRESSION CONTAINED | SUPPORT TO NON-COMMUNIST INSURGENTS |

▨ DETERRENCE/PEACE MAINTAINED
☐ CONFLICTS MANAGED OR CONTAINED
☐ DEFENSE COOPERATION/COALITION

OFFSET
CAMERA COPY

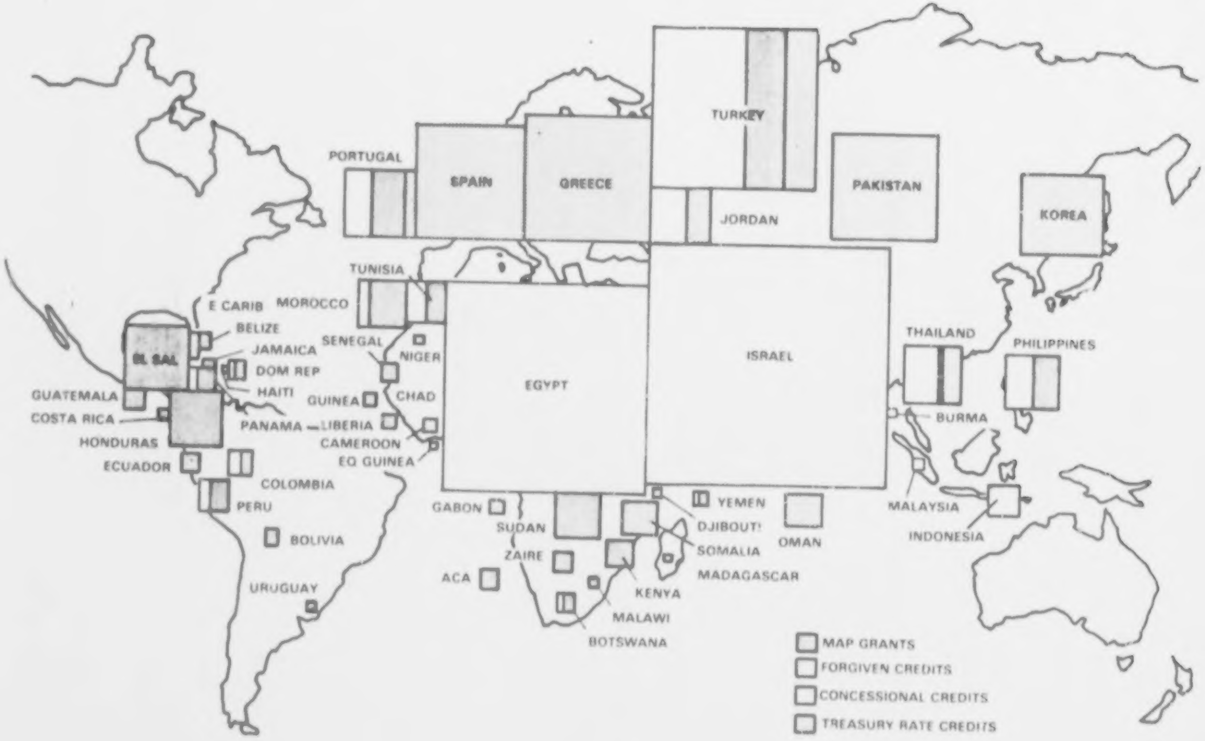
It is interesting and constructive to note where we have been and some of the accomplishments the United States Government, Administration and Congress have achieved in working together to help our friends and allies. We have in blue here those accomplishments for deterrence and where peace has been maintained, conflicts managed or contained in red, and defense cooperation coalition in green. There are some failures, of course. Here in red where conflicts have been deterred is Qadhafi, Western Sahara, Chad, Philippine support plan, the Gulf war contained, support to the Thais and El Salvador and so forth. Syria has been constrained, Egypt-Israeli peace maintained, and stability in the Koreas maintained.

Of course, through defense cooperation coalition we have been able to support our base rights countries and, we negotiated all of them. Moreover, through our help and working with exercises, we have assisted Honduras and Costa Rica.

The nature of our program for this year is reflected on earlier charts. By the way, these are the same scale in all cases here.

[Slide follows:]

## FY 1987 FMS/MAP FINANCING REQUEST
## (SCALED TO FINANCING)


PORTUGAL
SPAIN
GREECE
TURKEY
JORDAN
PAKISTAN
KOREA
TUNISIA
MOROCCO
E CARIB
BELIZE
JAMAICA
DOM REP
HAITI
EL SAL
GUATEMALA
COSTA RICA
HONDURAS
ECUADOR
PANAMA
COLOMBIA
PERU
BOLIVIA
URUGUAY
SENEGAL
NIGER
GUINEA
CHAD
LIBERIA
CAMEROON
EQ GUINEA
EGYPT
ISRAEL
THAILAND
PHILIPPINES
BURMA
MALAYSIA
INDONESIA
GABON
SUDAN
ZAIRE
ACA
YEMEN
DJIBOUTI
SOMALIA
OMAN
MADAGASCAR
KENYA
MALAWI
BOTSWANA
MAP GRANTS
FORGIVEN CREDITS
CONCESSIONAL CREDITS
TREASURY RATE CREDITS

OFFSET
CAMERA COPY

In our military assistance financing request, we take into cognizance the economic factors about to be considered. You all know in Egypt and Israel, our financing is forgiven. In Turkey, for example, we consider some concessional, some MAP as well as Treasury rate financing. In Pakistan this year, it is all Treasury, and also in Korea, Greece, and Spain.

But in Portugal, within the NATO Alliance, and Tunisia and others is reflected that spread and that balance of financing that is so necessary.

## LEGISLATIVE INITIATIVES

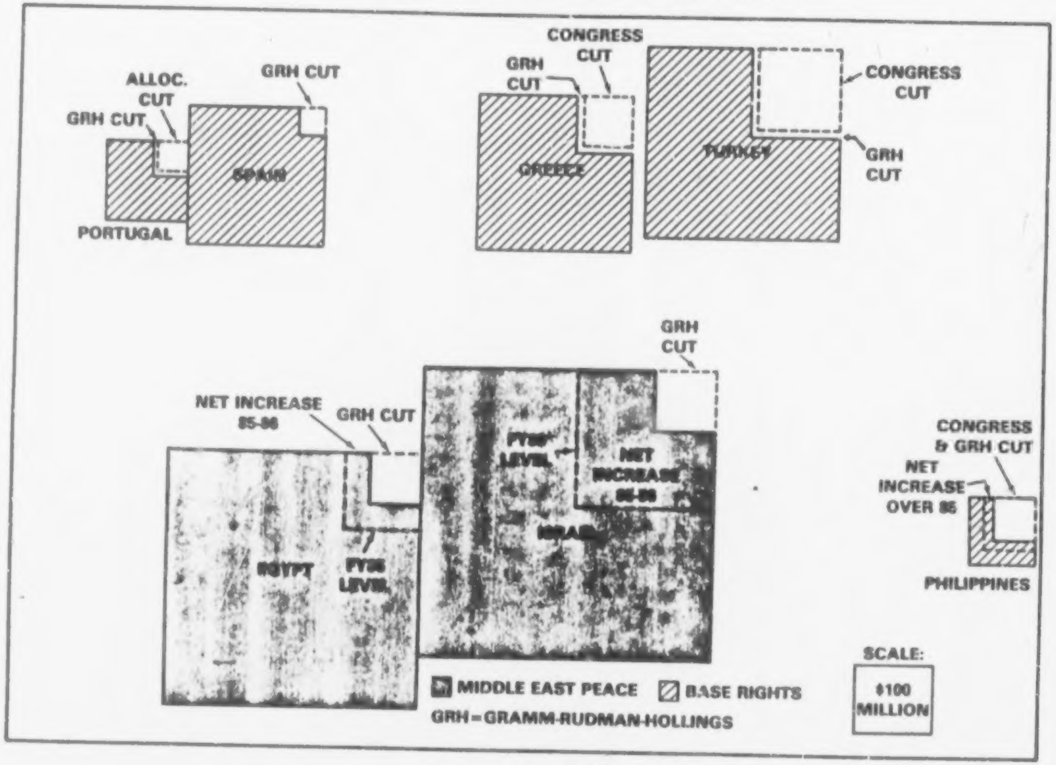
Within this plan, as Dr. Schneider indicated, I should mention two legislative initiatives which we support strongly: one is SDAF, where we would like to have the obligational authority for $350 million, and the other is a two-year obligational authority, Mr. Chairman. Because today under SDAF we must spend the money in one year, it leads to unwise decisions and uneconomical use of those decisions.

[Slide follows:]

#7

## FMSCR/MAP: CUTS FROM FY 86 REQUEST: ISRAEL, EGYPT, BASE RIGHTS COUNTRIES

* INCLUDES GRAMM-RUDMAN CUTS



OFFSET
CAMERA COPY

### BUDGET IMPACT

The impact of the reduced budget last year is apparent on this chart, and it is a combination of Gramm-Rudman-Hollings sequester, as well as reductions from the 85 levels as approved by Congress. This indicates, there in the dashed line, the increases to the budget last year that were supported by the Congress for Egypt and Israel. The only reduction is the 4.3 percent that was taken out because of the verification requirement right here in this area. In Turkey, there was a reduction in the amount owed, and I will come back to Turkey, plus the GRH.

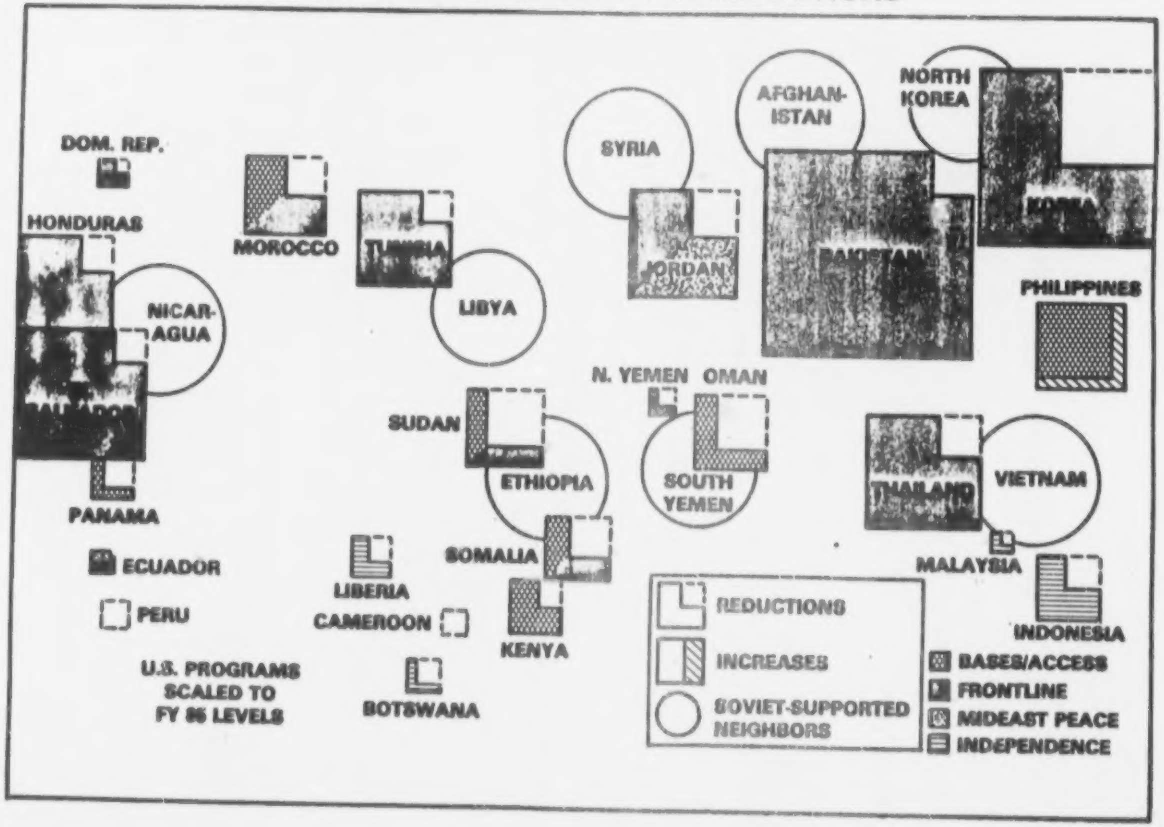
In Greece, there was a ten percent reduction in credits. We protected Spain and Portugal pretty well. We took only the Gramm-Rudman reduction from Spain here at 400—We also had to reduce Turkey. I have recently traveled to 11 countries that were impacted by the budget, not that I necessarily wanted to go at the time, but I had them pre-scheduled, to enter into dialogue with our people about where to start. In each of those countries they had to go back and review their defense plan, and, of course, they are asking us how to help them to expand their efforts.

[Slide follows:]

#8

## FMSCR/MAP: REDUCTIONS IN KEY PROGRAMS IN FY 86 FROM FY 85 LEVELS

* INCLUDES GRAMM-RUDMAN REDUCTIONS



OFFSET
CAMERA COPY

This map is a reflection, Mr. Chairman, of largely the rest of the world here, and I have shown Korea, Pakistan, Thailand, Tunisia and Morocco. In the circles are those countries that I had on the earlier chart, those troublemaking countries where we all know that at least there is instability, and the boxes show the impact of these reductions. In Korea, there was a sizable reduction about 30 percent below the President's request. Oman was reduced some 53 percent, Somalia some 40 percent, and North Yemen some 60 percent. Kenya has to be reduced, as well as Sudan. Tunisia was earmarked, but Morocco had to take about a 26 percent reduction. Jordan was also reduced but only by about 15%.

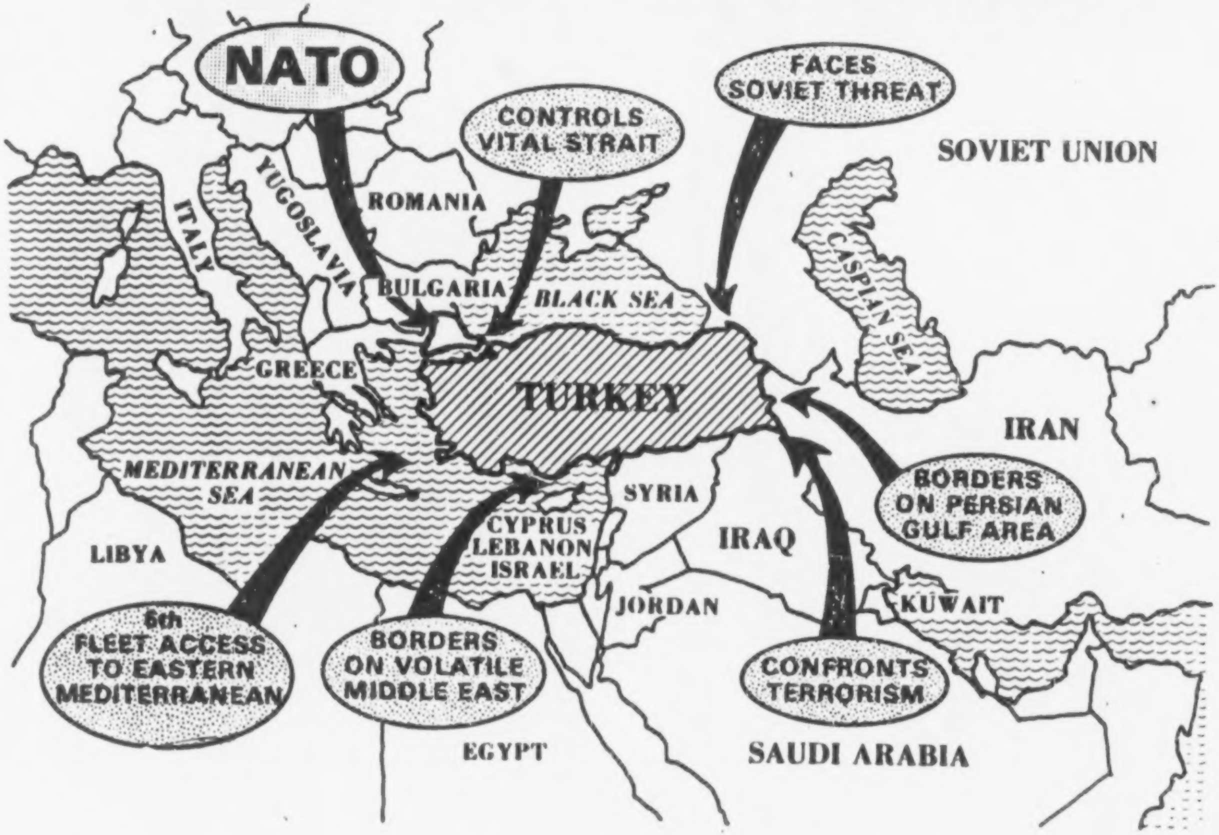
This would indicate not necessarily priorities, but, I guess priorities, because we had to spread the shortfalls, and they were significant shortfalls. In each of these countries in this particular region, countries have had to defer their modernization or plans in order to withstand the pressures I mentioned earlier on those charts.

### PIPELINE

There has also been some comment about the fact there are some unspent balances out there, countries have not drawn down on all of their loans. In most of those cases, it is for Greece, where they have been waiting to order or procure the F-16 and modernize their artillery. There are a few others that show up as being uncommitted, and they are largely due to the fact we work with the countries to save money, and they are re-investing in other programs. I wish to assure you, after traveling around, there has been a major impact on our countries, our friends and allies, who depend upon our assistance and are having to reschedule their whole defense requirements and still try to come up with a legitimate deterrent force.

[Slide follows:]

# TURKEY AT STRATEGIC CROSSROADS


NATO
CONTROLS VITAL STRAIT
FACES SOVIET THREAT
SOVIET UNION
ROMANIA
YUGOSLAVIA
ITALY
BULGARIA
BLACK SEA
CASPIAN SEA
GREECE
TURKEY
IRAN
MEDITERRANEAN SEA
SYRIA
BORDERS ON PERSIAN GULF AREA
IRAQ
CYPRUS
LEBANON
ISRAEL
LIBYA
JORDAN
KUWAIT
6th FLEET ACCESS TO EASTERN MEDITERRANEAN
BORDERS ON VOLATILE MIDDLE EAST
CONFRONTS TERRORISM
EGYPT
SAUDI ARABIA

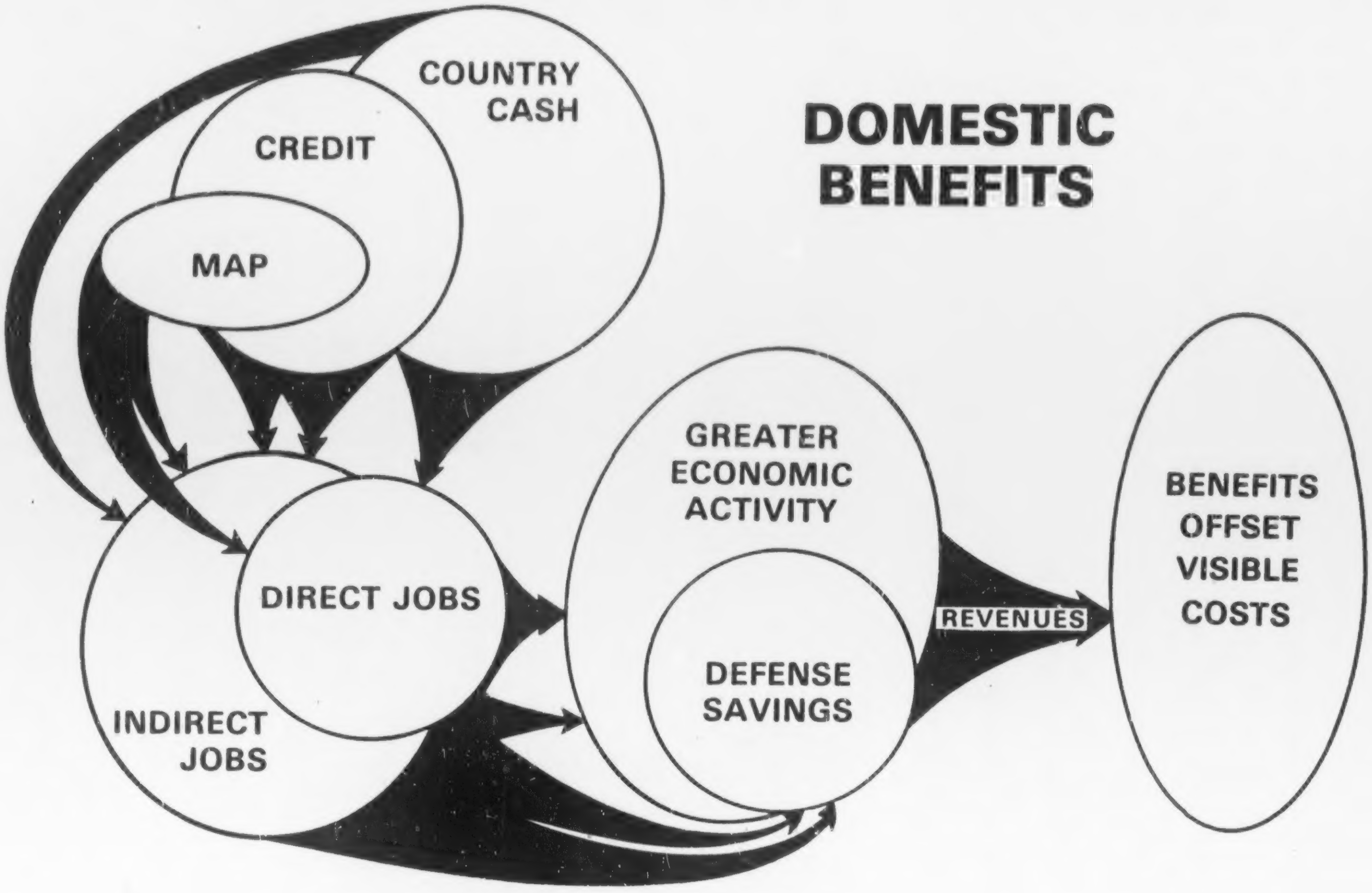
## TURKEY

It is always worthy to keep and talk about Turkey. The importance of Greece is also well known. Turkey did take a significant cut this year, they are back to $615 million. I just finished a three-day conference with them, and they are having difficulty structuring their programs. It is well known that they are at the nexus of our NATO strategy. They face the Soviet threat, control the vital straits, confront terrorism, border on the Gulf area, and so forth. Yet in this country its armed forces are growing into obsolescence. The programs we have had up until now are in tank modernization and procurement of the F-16 and a small frigate modernization program. This $615 million level stops at modernization.

At the same time that its neighbor to the north, the Soviet Union, is modernizing rapidly, there is no room at that level to begin any further modernization plans. Mr. Chairman, we all know that the reason we have a foreign assistance program is for our own foreign policy and our defense needs, and I don't wish to imply by even showing this chart we recognize it differently. Yet there are those who perhaps do not understand that this is not necessarily a give-away program.

[Slide follows:]

# DOMESTIC BENEFITS



COUNTRY CASH

CREDIT

MAP

DIRECT JOBS

INDIRECT JOBS

GREATER ECONOMIC ACTIVITY

DEFENSE SAVINGS

REVENUES

BENEFITS OFFSET VISIBLE COSTS

### BENEFIT TO THE U.S.

There is an interesting section here in the Congressional presentation document that gets to the domestic benefits that we have. Within our trust fund, our military sales are about $12 billion per year of sales. Those sales are only to meet legitimate defense requirements. We do not promote arms sales. It is to meet legitimate defense requirements. Nevertheless, that $12 billion is composed of national funds and U.S. Government financing, whether MAP or loans or concessional funds. That $12 billion would not be pumped into the U.S. economy if we did not have an adequate security assistance program.

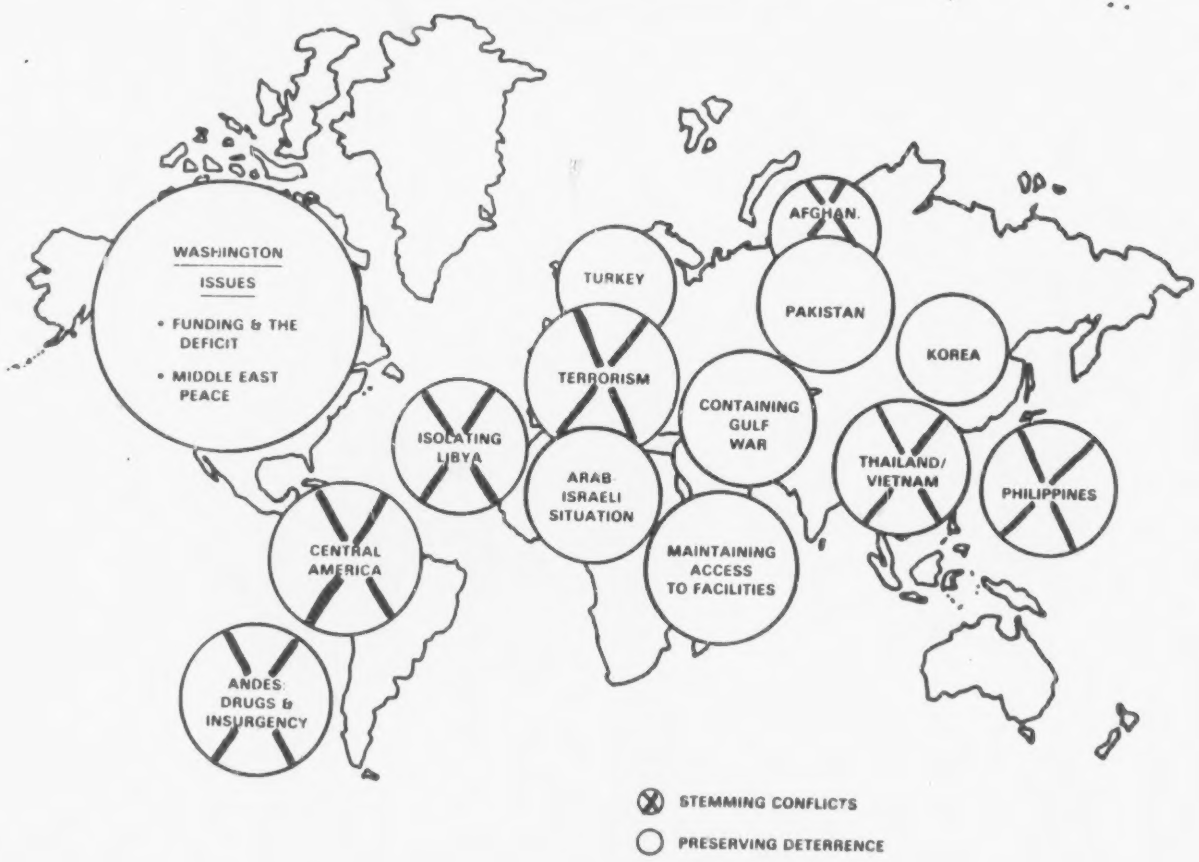
There is no other government that has a security assistance program like we do, where we have full United States Government involvement and where we respond to legitimate requests. When you add in the trust fund balance and consider the tax receipts from all of that, as created by those jobs sustained by our program, and you do not consider what is in the trust fund, it is provable on a very conservative basis that the budget deficit is about $2 billion, somewhere between 1.5 and 2.2.

If you consider the trust fund, it is not there, it is not a deficit.

Now, there are other calculations on how to achieve that which are available and we would be glad to show to you and your staff.

[Slide follows:]

# CHALLENGES AHEAD


WASHINGTON
ISSUES
• FUNDING & THE DEFICIT
• MIDDLE EAST PEACE
TURKEY
AFGHAN.
PAKISTAN
KOREA
TERRORISM
ISOLATING LIBYA
CONTAINING GULF WAR
THAILAND/ VIETNAM
PHILIPPINES
ARAB-ISRAELI SITUATION
CENTRAL AMERICA
MAINTAINING ACCESS TO FACILITIES
ANDES: DRUGS & INSURGENCY
STEMMING CONFLICTS
PRESERVING DETERRENCE

Finally, in summary, Mr. Chairman, I would point out these are the challenges, the largest is here in Washington, as you articulated during your opening comments, but also Middle east peace, but there is the Philippines——

Mr. OBEY. Was that there before Gramm-Rudman?

General GAST. It got bigger. It is one place where we hadn't cut. Korea, Pakistan, Afghanistan, and those red dots there where we believe, and I believe Congress would agree, we have made significant progress over the last four or five years working together. And our concern is, with any reductions through the previous charts there, we will lose ground indeed. Nevertheless, the Soviets are proceeding at a very fast rate.

Thank you, Mr. Chairman.

[The statement of Lieutenant General Philip C. Gast follows:]

STATEMENT OF

LIEUTENANT GENERAL PHILIP C. GAST
DIRECTOR, DEFENSE SECURITY ASSISTANCE AGENCY

BEFORE THE

SUBCOMMITTEE ON FOREIGN OPERATIONS
HOUSE APPROPRIATIONS COMMITTEE

6 MARCH 1986

STATEMENT
BEFORE THE SUBCOMMITTEE ON FOREIGN OPERATIONS
LTG PHILIP C. GAST
DIRECTOR, DEFENSE SECURITY ASSISTANCE AGENCY
6 MARCH 1986

## CHART 1: SECURITY ASSISTANCE - CONTRIBUTION TO NATIONAL DEFENSE

THANK YOU MR. CHAIRMAN. I WELCOME THE OPPORTUNITY TO COME BEFORE YOU AGAIN TO DISCUSS THE SECURITY ASSISTANCE PROGRAM. IN TERMS OF NATIONAL STRATEGY, SECURITY ASSISTANCE IS ONE OF THE MOST CRUCIAL PROGRAMS WE HAVE; UNFORTUNATELY, IT IS ALSO ONE OF THE LEAST UNDERSTOOD. THIS YEAR'S MILITARY PROGRAM OF $6.8 BILLION MAKES A CRITICALLY-NEEDED CONTRIBUTION TO THE DEFENSE OF THE U.S.; WITHOUT IT, OUR OVERALL DEFENSE EFFORT WOULD HAVE TO BE INCREASED BY A SUBSTANTIALLY LARGER AMOUNT.

I AM SURE YOU RECOGNIZE THE DIFFICULTIES IMPOSED UPON OUR REQUESTED PROGRAM THIS YEAR BY THE GRAMM-RUDMAN-HOLLINGS BUDGET CONSTRAINTS. WE HAVE COMPLIED WITH THOSE CONSTRAINTS FULLY, DESPITE THE PRESSURES OF OUR RESPONSIBILITIES AND THE PERILOUS NATURE OF A WORLD FILLED WITH WARS, TERRORISM, AND THE VIOLENT EXPLOITATION OF SOCIAL AND ECONOMIC ILLS BY THOSE WHO OPPOSE OUR MOST BASIC VALUES.

## CHART 2: MAJOR CHALLENGES TO THE PEACE

WE SEE HERE THE WELL-KNOWN TROUBLE SPOTS. FIRST, REPRESENTED BY THE RED CIRCLES ARE THE PROBLEM COUNTRIES SPREAD IN A BAND ACROSS THE CENTER OF THE GLOBE. THESE NATIONS ARE OFTEN THE

SOURCE OF THE MILITARY THREATS TO OUR FRIENDS; SOME OF THEM ARE ALSO THE SOURCE OF ANOTHER WORLDWIDE PROBLEM, REPRESENTED BY THE RECTANGLES --TERRORISM THAT THREATENS THE INNOCENT. FINALLY, WE SEE THE YELLOW TRIANGLES THAT REPRESENT THE MAJOR INSTABILITIES THAT CONCERN US.

STARTING IN THE FAR EAST WE SEE TWO OF THE MOST THREATENING NATIONS, NORTH KOREA AND VIETNAM. MOVING DOWN, WE ARE ALL FAMILIAR WITH THE PROBLEMS CONFRONTING THE PHILIPPINES. I BELIEVE NONE OF US IN THIS ROOM WANTS TO SEE THE PHILIPPINE PEOPLE HAVE THEIR FUTURE DECIDED BY THE COMMUNIST INSURGENCY, WHICH CURRENTLY EXACERBATES THEIR OTHER, WELL-KNOWN DOMESTIC DIFFICULTIES. ONE THING IS CERTAIN: THE COMMUNIST INSURGENTS WILL CONTINUE THEIR RELENTLESS DRIVE TO SEIZE POWER. THEY WILL SEEK TO EXACERBATE FISSURES IN PHILIPPINE SOCIETY AND THEY WILL EXPLOIT ANY WEAKNESSES IN THE ABILITY OF THE ARMED FORCES OF THE PHILIPPINES TO DEFEND THAT SOCIETY.

WE WILL CONTINUE TO MONITOR THE SITUATION IN THE PHILIPPINES. OUR SECURITY ASSISTANCE PROGRAM CAN BE RESPONSIVE TO THE NEEDS OF THE AFP AND THE REQUESTS OF THE AQUINO GOVERNMENT. AT THIS STAGE, WE SEE THE REQUIREMENTS OF THE AFP TO BE THE CORRECTION OF DEFICIENCIES IN TRANSPORTATION, COMMUNICATION, LOGISTIC SUPPORT, TRAINING, AND TROOP WELFARE.

EAST ASIA AND THE PACIFIC HAVE IMPORTANT ECONOMIC AND SECURITY TIES TO THE U.S. BY USING SECURITY ASSISTANCE TO HELP SOUTH KOREA

MAINTAIN DETERRENCE AND THAILAND AND THE PHILIPPINES COPE WITH ON-GOING CONFLICTS AND THREATS, WE DETER HOSTILE INTERFERENCE WITH THE INDEPENDENCE AND STABILITY OF THESE COUNTRIES AND CONTRIBUTE DIRECTLY TO OUR OWN DEFENSE AS WELL.

THE SOVIET PRESENCE IN AFGHANISTAN, THE PERSISTENT IRAN-IRAQ WAR, AND THE OMINOUS INSTABILITY OF MARXIST SOUTH YEMEN MAKES THE OIL-RICH SOUTHWEST ASIA REGION A PARTICULARLY VOLATILE AREA. OUR SECURITY ASSISTANCE AND ARMS SALES PROGRAMS IN THIS REGION HELP CONTAIN THE VIOLENCE AND ENABLE US TO BOLSTER LOCAL DETERRENCE WHILE COMPLEMENTING OUR SOUTHWEST ASIA STRATEGY. NEARBY ETHIOPIA, THE SOVIET UNION'S MAJOR CLIENT IN SUB-SAHARAN AFRICA, CONTINUES TO THREATEN THE PEACE ON THE HORN DESPITE ITS OWN PROBLEMS WITH FAMINE.

CLOSER TO HOME, OUR SECURITY ASSISTANCE THROUGHOUT CENTRAL AMERICA HAS MADE IMPRESSIVE STRIDES IN COMBATTING INSURGENCY, SUPPORTING DEMOCRACY AND IMPROVING ECONOMIC CONDITIONS, ESPECIALLY IN EL SALVADOR. HOWEVER, WE MUST BE EVER COGNIZANT OF NATIONS IN THE REGION INTENT UPON CREATING TROUBLE AND INSTIGATING VIOLENCE IN THE HEMISPHERE. WE KNOW THAT CUBA HAS LONG BEEN AN ADVERSARY BUT WE NOW MUST BE MINDFUL OF THE SANDINISTAS IN NICARAGUA AND THE IMPLICATIONS OF CONSOLIDATED SANDINISTA POWER.

THE MAGNITUDE OF WORLDWIDE TERRORISM AND, IN OUR HEMISPHERE, THE ILLEGAL TRADE IN DRUGS POSE SERIOUS CHALLENGES. WHILE OUR SECURITY ASSISTANCE PROGRAMS HAVE NOT TRADITIONALLY DEALT WITH

THESE PROBLEMS, WE HAVE BEGUN TO STRUCTURE AN EFFECTIVE RESPONSE TO THIS SCOURGE.

CHART 3: SOVIET MILITARY/ECONOMIC ASSISTANCE

A GLANCE AT THIS CHART IS ENOUGH TO REVEAL THE STRIKING CORRELATION BETWEEN THE PROBLEM NATIONS WE HAVE JUST DISCUSSED AND THE NATIONS RECEIVING SOVIET MILITARY SALES AND ASSISTANCE. THIS CHART SHOWS, IN RED, SOVIET MILITARY SALES, WHICH ARE OFTEN ON QUITE FAVORABLE TERMS, AND IN GREEN, SOVIET ECONOMIC AID. YOU WILL NOTE THE PREPONDERANCE OF RED. THEIR PROVISION OF MILITARY ASSISTANCE AND ADVICE TO NORTH KOREA, VIETNAM, SOUTH YEMEN, ETHIOPIA, ANGOLA, SYRIA, LIBYA, NICARAGUA AND CUBA SUPPORTS A POLICY OF FUELING THE FIRES OF MARXIST IDEOLOGY AND AGGRESSION. THERE ARE MORE SOVIET SECURITY ASSISTANCE ADVISORS IN LATIN AMERICA THAN WE HAVE IN THE ENTIRE WORLD AND ABOUT TWICE AS MANY IN SUB-SAHARAN AFRICA AS OUR WORLDWIDE TOTAL.

THE SOVIETS HAVE NO LAW BUT THEIR OWN WILL FOR POWER GOVERNING THEIR MILITARY ASSISTANCE; NO LEGISLATIVE REVIEW PROCESS SETTING THE CONSTRAINTS OF THEIR OVERSEAS ACTIVITY; AND THE SOVIET POPULACE DOES NOT VALIDATE THE CHOICES OF THEIR LEADERS.

OUR SECURITY ASSISTANCE PROGRAM IS SUBJECT TO CONGRESSIONAL AND OPEN PUBLIC REVIEW. IT IS ULTIMATELY VALIDATED, AS IT SHOULD BE, THROUGH OUR DEMOCRATIC PROCESS.

## CHART 4: U.S. ECONOMIC AND MILITARY PROGRAMS

THIS CHART SHOWS THE BALANCE BETWEEN OUR ECONOMIC AND MILITARY ASSISTANCE. AS IN THE SOVIET CHART, RED REPRESENTS MILITARY AID WHILE GREEN STANDS FOR ECONOMIC ASSISTANCE. UNITED STATES FOREIGN ASSISTANCE PROGRAMS HAVE A VERY DIFFERENT CHARACTER FROM THOSE OF THE SOVIET UNION: WE PROVIDE MILITARY ASSISTANCE FOR DEFENSE ONLY. WE FAVOR ECONOMIC OVER MILITARY ASSISTANCE BY A 60 TO 40 RATIO OVERALL AND A RATIO MUCH HIGHER THAN THAT IN MOST OF THE THIRD WORLD. THIS LAST POINT IS SOMETHING THAT IS OFTEN MISUNDERSTOOD; PLEASE RECALL THAT ESF, THOUGH PART OF THE SECURITY ASSISTANCE BUDGET IS PURELY ECONOMIC AID.

WE TARGET THE NEEDS OF OUR RECIPIENTS. AS THIS CHART ILLUSTRATES, WE ARE SENSITIVE TO THE ECONOMIC ROOTS OF MANY PROBLEMS OF CENTRAL AMERICA, SOUTH AMERICA AND SOUTHERN AFRICA. GENERALLY, WE ATTEMPT TO ACHIEVE A BALANCE IN EACH COUNTRY THAT IS APPROPRIATE TO ITS SITUATION. IN KOREA, FOR EXAMPLE, A SIZABLE MILITARY INPUT OF CREDIT ASSISTANCE IS NEEDED BECAUSE OF OUR MUTUAL NEED TO MAINTAIN A DETERRENT AGAINST THE NORTH. KOREA'S GROWING PROSPERITY MAKES ECONOMIC AID UNNECESSARY, AND OUR MILITARY ASSISTANCE IS IN THE FORM OF NEAR-MARKET INTEREST RATES. IN EGYPT, ISRAEL, PAKISTAN AND THE PHILIPPINES, ON THE OTHER HAND, WE NEED A BALANCED MIX OF BOTH ECONOMIC AND MILITARY ASSISTANCE BECAUSE OF THE NATURE OF THE THREAT FACING THOSE COUNTRIES AND THE NEED TO ADDRESS THE SERIOUS PROBLEMS OF THEIR ECONOMIES. FOR OUR

SOUTHERN EUROPEAN ALLIES, OUR MILITARY ASSISTANCE HELPS THEM PURSUE NATO-RELATED FORCE GOALS, AS WELL AS SECURING BASE RIGHTS FOR U.S. FORCES. IN GREECE AND TURKEY, WE AUGMENT THIS WITH ECONOMIC ASSISTANCE.

## CHART 5: PURSUIT OF OBJECTIVES

THIS CHART SHOWS SOME OF THE ACHIEVEMENTS OF OUR SECURITY ASSISTANCE PROGRAM. THE RECORD SHOWS THAT SECURITY ASSISTANCE PROGRAMS IN CONCERT WITH OTHER FOREIGN POLICY TOOLS HAVE HELPED ACHIEVE SOME REMARKABLE RESULTS, MOST NOTABLY IN THE GENERAL AREAS OF DETERRENCE AND CONFLICT MANAGEMENT, AS WELL AS IN PROMOTING COLLECTIVE SECURITY.

WE HAVE PRESERVED DETERRENCE IN AREAS OF POTENTIAL MAJOR CONFLICTS, SUCH AS THE MIDDLE EAST, SOUTHWEST ASIA, KOREA, AND THE NATO AREA.

CONFLICTS HAVE BEEN MITIGATED OR CONTAINED IN CENTRAL AMERICA, THE WESTERN SAHARA, CHAD, THE OGADEN REGION BETWEEN ETHIOPIA AND SOMALIA, YEMEN, THE PERSIAN GULF, AND THAILAND. FOR EXAMPLE, BY IMPROVING REGIONAL STATES' AIR DEFENSE AND NAVAL PATROLS IN THE GULF, OUR SECURITY ASSISTANCE HAS CONTRIBUTED TO CONTAINMENT OF THE IRAN-IRAQ WAR. THE RECENT LIBYA-SUPPORTED FLARE-UP IN CHAD, THE INTENSIFICATION OF THE IRAN-IRAQ WAR, THE DANGER SIGNS IN YEMEN AND THE PHILIPPINES, DRIVE HOME THE LESSON THAT THE

UNEXPECTED CONTINUES TO OCCUR. WE MUST NEVER FORGET THAT NONE OF OUR ACHIEVEMENTS ARE FINAL -- ALL REQUIRE CONTINUED VIGILANCE.

OUR ASSISTANCE HAS ALSO SIGNALED TROUBLEMAKERS IN THE WORLD THAT THREATS TO THEIR NEIGHBORS WILL BE MET WITH APPROPRIATE RESPONSES. OUR ASSISTANCE TO PAKISTAN IS A STRONG SIGNAL TO THE SOVIET UNION THAT ITS AGGRESSION IN AFGHANISTAN CANNOT GO FURTHER. OUR ASSISTANCE TO THAILAND SIGNALS OUR FIRM COMMITMENT TO THAT COUNTRY FACING THE THREAT FROM VIETNAMESE FORCES IN CAMBODIA.

WITH THE COOPERATION OF HOST NATIONS, WE HAVE IMPROVED THE POSTURE AND DEPLOYMENT OF U.S. FORCES. IN THE PAST FIVE YEARS, WE HAVE RENEGOTIATED BASE RIGHTS AGREEMENTS WITH ALL FIVE COUNTRIES WHERE A FORMAL RELATION BETWEEN SECURITY ASSISTANCE AND STRATEGIC COOPERATION EXISTS, I.E., PORTUGAL, SPAIN, GREECE, TURKEY, AND THE PHILIPPINES. WE HAVE MAINTAINED ACCESS TO FACILITIES IN OMAN, SOMALIA, KENYA, MOROCCO, AND EGYPT, AND HAVE BEGUN SIMILAR ARRANGEMENTS WITH DJIBOUTI. ONE RESULT IS THAT U.S. FORCES HAVE INCREASED THEIR COOPERATIVE EXERCISES WITH LOCAL FORCES, ESPECIALLY IN CENTRAL AMERICA, THE MIDDLE EAST, AND THAILAND.

IN LARGE MEASURE, OUR PROGRAMS HAVE BEEN DESIGNED TO RESPOND TO SOVIET-SUPPORTED CHALLENGES AROUND THE WORLD. IN PRACTICAL TERMS, THIS MEANS THAT, WHEREVER THEY HAVE AGGRESSIVE CLIENTS OR ARE EXPLOITING LOCAL INSTABILITIES, WE TRY TO ASSIST THE NEIGHBORING STATES.

## CHART 6: FY87 FMS/MAP FINANCING

THIS CHART REPRESENTS THE PROPOSAL FOR MILITARY ASSISTANCE THIS YEAR. AS YOU CAN SEE, ITS COMPONENTS ARE COLOR-CODED TO COVER THE SEVERAL FORMS OF FINANCING. THE BLOCKS ARE SCALED TO THE SIZE OF THE COUNTRY PROGRAM. IT DOES NOT DIFFER MUCH FROM OUR PROPOSAL OF LAST YEAR. THE TOP SEVEN COUNTRIES STILL RECEIVE ABOUT 80 PERCENT OF WHAT WE PROPOSE. WE ARE CONTINUING TO SHIFT TO MORE CONCESSIONAL TERMS; YOU WILL NOTE THAT MOST OF OUR FUNDS FOR AFRICA AND LATIN AMERICA ARE GRANTS. THE TOTAL FUNDING REQUEST IS APPROXIMATELY AT THE LEVEL OF OUR FY86 REQUEST AND IS FULLY COMPLIANT WITH THE GRAMM-RUDMAN-HOLLINGS CONSTRAINTS. THE FEW INCREASED ITEMS IN THE PROGRAM ARE TO MEET OUR COMMITMENTS TO BASE RIGHTS COUNTRIES, OR TO COPE WITH SPECIFIC AND URGENT PROBLEMS THAT HAVE ARISEN LATELY, AS IN SOUTH AMERICA, OR TO AVOID CUTTING IMPORTANT COUNTRY PROGRAMS BELOW FY85 LEVELS.

IN ADDITION TO SECURITY ASSISTANCE FUNDING IN THE BUDGET, WE ARE REQUESTING $350 MILLION IN OBLIGATION AUTHORITY TO USE THE FUNDS IN THE SPECIAL DEFENSE ACQUISITION FUND (SDAF). WE HAD $325 MILLION LAST YEAR. WE ARE ALSO ASKING ONCE AGAIN FOR AN EXTENSION OF THE PERIOD IN WHICH WE CAN EXERCISE THIS OBLIGATION AUTHORITY - TO TWO YEARS, IN ORDER TO CONDUCT MORE DELIBERATE CONTRACTING AND STAY CLOSER TO DOD PROCUREMENT PRACTICES. WE ARE ALSO ASKING THE ARMED SERVICES COMMITTEES FOR AN INCREASE OF $100 MILLION IN CAPITALIZATION SO THAT WE CAN CONTINUE SPENDING AT THE $300-350 MILLION LEVEL.

THE ONLY OTHER LEGISLATIVE INITIATIVE WE HAVE SUBMITTED TO YOU IS TO RAISE THE THRESHOLD FOR IMET REPROGRAMMING NOTIFICATIONS TO $25 THOUSAND. WE PROPOSED THIS LAST YEAR, AND IT WAS SUPPORTED IN THE AUTHORIZATION BILL.

## CHART 7: REDUCTIONS IN FY86 FROM FY86 REQUEST

LET ME RECAP WHAT HAPPENED TO LAST YEAR'S FY86 BUDGET. FOR FISCAL YEAR 1986, WE HAD TO MAKE A NUMBER OF SEVERE CUTS IN CRITICAL AREAS AS A RESULT OF A REDUCED APPROPRIATION FOLLOWED BY GRAMM-RUDMAN-HOLLINGS CUTS OF 4.3 PERCENT. THIS MAP SHOWS WHERE CONGRESS OR GRAMM-RUDMAN-HOLLINGS REQUIREMENTS, HAVE CUT PROGRAMS BELOW THE FY86 REQUEST IN OUR ALLOCATION FOR FY86. THE SCALE IS RELATIVE TO FINANCING, AND WE HAVE INCLUDED ISRAEL, EGYPT, AND BASE RIGHTS PROGRAMS. THE FULL BOX REPRESENTS FY85 LEVELS, AND THE NOTCH ON THE BOX IS THE REDUCTION FROM THE FY86 REQUEST. NOTE THAT WHILE ISRAEL AND EGYPT RECEIVED THE GRAMM-RUDMAN-HOLLINGS CUT, THEY STILL WERE INCREASED OVER FY85 LEVELS.

## CHART 8: REDUCTIONS IN FY86 FROM FY85 LEVELS

ON THIS CHART WE SHOW THE CUTS TO THE REST OF THE WORLD. NOTE THAT THE SCALE ON THIS CHART IS CHANGED TO ACCOMMODATE THE SMALLER PROGRAMS. MANY PROGRAMS WERE CUT BELOW FY85 LEVELS IN OUR ALLOCATION FOR FY86. MANY OF THE MAJOR CUTS WERE FOR COUNTRIES WHICH ARE NEIGHBORS OF COUNTRIES RECEIVING MAJOR SOVIET SUPPORT REPRESENTED ON THIS CHART BY THE CIRCLES.

BECAUSE ISRAEL AND EGYPT, AS WE SHOWED ON OUR PREVIOUS CHART, INCREASED SO MUCH WITHIN A SHRINKING TOTAL, OTHER CUTS WERE FAR MORE SEVERE. OBVIOUSLY, THERE IS THE POTENTIAL FOR REAL DAMAGE TO KEY COUNTRY DEFENSES, TO OUR RELATIONS WITH OUR CLOSEST SECURITY PARTNERS, AND TO OUR OWN STRATEGIC INTERESTS.

WE WORRY THAT THESE DISPROPORTIONATE CUTS, FORCED BY EARMARKED INCREASES FOR ISRAEL AND EGYPT, MAY ACTUALLY ENDANGER DETERRENCE, ESPECIALLY IN SOUTH KOREA, THAILAND, PAKISTAN, SOMALIA, AND TUNISIA. FUNDS TO SOUTH KOREA AND SOMALIA HAD TO BE CUT BY 30 AND 42 PERCENT RESPECTIVELY. AT A TIME OF TURMOIL IN SOUTH YEMEN AND THE POSSIBILITY OF ITS RETURN TO A MORE AGGRESSIVE POSTURE, NORTH YEMEN AND OMAN NEED OUR SUPPORT. OMAN'S PROGRAM HAD TO BE REDUCED BY 53 PERCENT, AND NORTH YEMEN'S BY ALMOST 62 PERCENT. MOROCCO CONTINUES TO BE PLAGUED BY ECONOMIC PROBLEMS, INCLUDING THE DRAIN OF THE WAR IN THE WESTERN SAHARA, IN WHICH IT HAS BEEN OTHERWISE SUCCESSFUL. BUT WE WERE FORCED TO CUT FUNDS TO MOROCCO BY 26 PERCENT. IN CENTRAL AMERICA WE HAVE MADE A GREAT DEAL OF PROGRESS BUT THE INSURGENCIES THERE STILL EXIST AND THE SITUATION REMAINS FRAGILE.

## CHART 9: TURKEY AT STRATEGIC CROSSROADS

WE ARE VERY CONCERNED ABOUT THE CUT WHICH WAS IMPOSED ON THE PROGRAM FOR TURKEY, ONE OF OUR MOST IMPORTANT NATO ALLIES POSITIONED AT THE NEXUS OF SEVERAL OF OUR REGIONAL STRATEGIES. THE TURKISH PROGRAM IS ONE OF THE MOST CAREFULLY STRUCTURED AND

IS FRAMED TO MEET NATO REQUIREMENTS IN THE CONTEXT OF GROWING OBSOLESCENCE IN THE TURKISH INVENTORY. CUTTING TURKEY WELL BELOW THE FY85 LEVEL, JUST TO OBTAIN A 7:10 RATIO WITH GREECE, MAKES NO PROGRAMMATIC SENSE, ALLOWS FOR NO NEW PROGRAMS AND SENDS THE WRONG SIGNAL TO OUR ALLIES AND ADVERSARIES.

CONGRESS REDUCED TURKEY BY ABOUT $170 MILLION BELOW THE FY86 REQUEST, OR ABOUT $57 MILLION BELOW THE FY85 LEVELS, EVEN BEFORE APPLICATION OF GRAMM-RUDMAN-HOLLINGS. AN ADDITIONAL CUT OF APPROXIMATELY $28 MILLION RESULTED FROM SEQUESTRATION. THE FINAL RESULT OF FY86 ACTIONS WAS A PROGRAM OF ABOUT $615 MILLION WHICH SIMPLY IS INSUFFICIENT TO MEET TURKEY'S MODERNIZATION NEEDS.

## CHART 10: DOMESTIC BENEFITS

OF COURSE, I AM SENSITIVE TO THE NEED FOR BUDGETARY PRUDENCE AND I REALIZE THAT MANY OF THE CUTS WE HAVE JUST NOTED WERE CAUSED BY CONGRESS'S DESIRE TO REDUCE THE DEFICIT. BUT THERE IS ANOTHER SIDE TO SECURITY ASSISTANCE, BENEFITS TO OUR OWN ECONOMY, WHICH ARE TOO OFTEN OVERLOOKED. THIS CHART ATTEMPTS TO SHOW THE DYNAMICS OF THE ECONOMIC BENEFITS OF THIS PROGRAM. WHETHER OR NOT THE U.S. HAS A SECURITY ASSISTANCE RELATIONSHIP WITH A PARTICULAR COUNTRY IS A MATTER OF FOREIGN POLICY OBJECTIVES AND NATIONAL SECURITY GOALS. IT IS, HOWEVER, EQUALLY IMPORTANT FOR BOTH CRITICS AND SUPPORTERS OF THE PROGRAM TO UNDERSTAND THAT THERE ARE REAL ECONOMIC BENEFITS THAT ACCRUE TO US AS A NATION AS A RESULT OF OUR SECURITY ASSISTANCE PROGRAMS.

APPROXIMATELY 70 TO 75 PERCENT OF FMS PURCHASES ARE MADE WITH FOREIGN NATIONAL FUNDS. THIS INFLOW OF CASH TENDS TO OFFSET, TO A CERTAIN EXTENT, THE FUNDS APPROPRIATED FOR FINANCING. WHEN OFFSETTING REVENUES (SUCH AS TAXES, INTEREST PAYMENTS, ETC.) ARE FACTORED IN, WE ESTIMATE THAT THE FY87 REQUEST FOR SECURITY ASSISTANCE APPROPRIATION, POTENTIALLY ADDS TO THE DEFICIT BY ABOUT $1.5 BILLION TO $2.5 BILLION. ON THE OTHER HAND, OVER THE LAST THREE YEARS, THE AVERAGE TRUST FUND BALANCE FOR FOREIGN NATIONAL FUNDS HAS BEEN AT LEAST $4 BILLION. THIS $4 BILLION COUNTS POSITIVELY AGAINST THE DEFICIT. THUS, IN THE FINAL ANALYSIS, OUR TOTAL FMS PROGRAM POTENTIALLY REDUCES THE DEFICIT IN A RANGE OF $1.5 BILLION TO $2.5 BILLION PER YEAR AT RECENT LEVELS OF ACTIVITY.

TAKEN AS A WHOLE, THE FOREIGN MILITARY SALES PROGRAM (WHETHER THE SALE IS FINANCED BY THE U.S. GOVERNMENT OR NOT) DIRECTLY SUSTAINS OR CREATES AN ESTIMATED 265,000 - 371,000 MAN-YEARS OF JOBS ANNUALLY. THE PROGRAM IS NOT A DRAIN ON THE ECONOMY. IT IS THE VISIBLE EXPENSE OF SECURITY ASSISTANCE FINANCING IN THE FEDERAL BUDGET WHICH OBSCURES THE FACT THAT THE U.S. CLEARLY RECEIVES SUBSTANTIAL ECONOMIC BENEFITS FROM THE OVERALL PROGRAM.

## CHART 11: MAJOR CHALLENGES AHEAD

THE MEASURE OF STABILITY AND DETERRENCE WE HAVE ACHIEVED IS PRECARIOUS, SINCE THE SOURCES OF CONFLICTS AND THREATS STILL REMAIN AND WE ARE OPERATING ON MINIMAL RESOURCE LEVELS. THE MAJOR CHALLENGES ARE SHOWN ON THIS CHART. IN GENERAL, THE CONSOLIDATION

OF THE POLICY ACHIEVEMENTS OF THE LAST FIVE YEARS, THE EXTENSION OF THESE SUCCESSES INTO THE FUTURE, AND REINVIGORATED CONTAINMENT OF SOVIET AND RADICAL AMBITIONS ARE NEAR-TERM CHALLENGES FOR SECURITY ASSISTANCE.

THE ADMINISTRATION AND CONGRESS HAVE WORKED CLOSELY OVER THE LAST FIVE YEARS TO FUND THE CRITICALLY IMPORTANT SECURITY ASSISTANCE PROGRAM. WE HAVE TRIED TO ASSIST COUNTRIES IN COPING WITH BOTH THEIR DEFENSE NEEDS AND ECONOMIC PROBLEMS IN A BALANCED MANNER. TODAY, THE BALANCE OF OUR PROGRAM AMONG STRATEGICALLY VITAL PARTNERS IS THREATENED BY THE EARMARKING OF LARGE FUNDING INCREASES FOR JUST TWO RECIPIENTS IN THE FACE OF SIZABLE CUTS IN THE PROGRAM TOTAL. DISASTROUS CONSEQUENCES FROM GRAMM-RUDMAN-HOLLINGS CONSTRAINTS CAN BE AVOIDED ONLY IF CONGRESS ALLOWS US (A) TO SHARE THE CUTS MORE EQUITABLY AMONG NATIONS; AND (B) TO HAVE ENHANCED REPROGRAMMING FLEXIBILITY TO OFFSET THE RIGIDITY OF GRAMM-RUDMAN-HOLLINGS.

POTENTIAL AND ACTUAL CONFLICTS AND THEIR ROOT CAUSES PERSIST. THEY POSE THREATS TO STRATEGIC STABILITY AND TO THE PROMOTION OF DEMOCRATIC PRINCIPLES THROUGHOUT THE WORLD. THE CHALLENGES -- TO PRESERVE STABILITY AND THE RELIABILITY OF THE U.S. AS A DEFENSE PARTNER; TO ENSURE CONTINUED IMPROVEMENTS IN THE FORCE STRUCTURE OF OUR ALLIES AND ACCESS FOR U.S. FORCES OVERSEAS; AND TO COPE WITH CONFLICTS, INCLUDING TERROR AND RADICAL AGGRESSION -- WILL HAVE TO BE CONFRONTED WITH NEW FLEXIBILITY TO OFFSET SEVERE U.S. BUDGET RESTRAINTS.

Mr. **Obey**. Thank you, General.

Because I have a tendency to take so much time in initial questions and statements and because I do have a lot of questions I have to ask, so that we have adequate documentation in the record, what I would like to do is defer my questioning for the moment and have other members proceed with their questions before I ask mine.

Mr. Porter.

### DIVERSION OF U.S. AID TO THE PHILIPPINES

Mr. **Porter**. Several news organizations, regarding the Philippines, have reported that USFMS sales have been handled by a company called Am Corporation based in California. It is reported they have been involved in diverting several million dollars of U.S. military aid through a double invoicing procedure.

Reports also link them to General Fabian Ver and his associates. What do we know about Am Corp and its involvement with the Philippines?

General **Gast**. Mr. Porter, I believe that the company's name is Am World.

Mr. **Porter**. Am World?

General **Gast**. Yes, sir. It involved a commercial purchase of communications equipment more than a year-and-a-half ago, or so through DSAA, which was financing this commercial contract. We are not a party to the contract, but we look at the contract, and if we feel it is justified, finance it. The money never leaves this country. It is given to the contractors.

We felt that there were some irregularities as the contract proceeded. We terminated the payments, about a third of the contract value, turned it over to the investigative services within the Pentagon. We first asked for an audit. That caused us to terminate payments. We turned it over to investigative services, and finally to Justice, who has a grand jury looking into it now. I am not at liberty to say anything further becasue it is in the hands of the grand jury.

What it does point out is that there is a need to watch FMS financing of private contracts carefully. We have strengthened our guidelines an awful lot in order to be sure we don't have other cases such as that.

Mr. **Porter**. Are you free to say what irregularities did you notice that led you to suspect there was something—

General **Gast**. Here, again, I would not want to go into detail because there is grand jury involvement. But it had to do with our tracing down as to deliveries and high rate of payments involved in the case.

### AID TO LIBERIA

Mr. **Porter**. I wonder if you could comment upon why we are proposing a $10 million aid program to Liberia, and isn't that somewhat analogous to the situation in the Philippines, except that the fraudulent side seems to have won in their election in the coup attempt? Why are we supporting them when we have in the case of the Philippines attempted to change the situation around?

Mr. **Schneider**. Well, Mr. Porter, the situation in Liberia had been a source of concern, but there have been some developments that have taken place subsequent to that election that are of some benefit.

For example, in January of 1986, Liberia put into place a new constitution which provides guaranties for the political and civil rights of individual citizens. There is also formal inauguration of a civilian government, the opposition party's Presidential candidates who have been arrested in the wake of the November 12th coup attempt have all been released, and none were indicted for involvement in the coup. The new government has promised civil open court trials for any civilian charged with complicity in the coup.

So far four have been indicated. Another opposition party Senator has been charged, but not yet indicted. The five cases remain a source of concern, but we are pleased that the Liberian Government has granted visas to members of a number of human right organizations to observe the trials. So we are concerned about the situation in Liberia, but in some ways not so unlike the situation in the Philippines. The ties that the United States gets with the military entity in the government can prove to be very important. I think it was our ties with the military in the Philippines that was the decisive element in making a turn towards democracy rather than chaos there.

So I think that the diplomatic efforts we are making to improve the situation for the democratic process there, on the one hand, and, on the other hand, using the military assistance instrument to maintain the contact with the military, improve their professionalism and respect for democratic institutions and will in the long run pay off in what is admittedly not a particularly good situation.

I think we are on the road to a comeback. So I hope you will help us with it.

Mr. **Porter**. It might be wise to put this money is some kind of escrow to see how their commitments to human rights, democracy and pluralism really turn out.

Mr. **Schneider**. I appreciate the point you are making, and it is a delicate problem, as to how it is managed, because the point is we want to have our people in contact with their people, leaning on them all the time to do the right thing as far as encouraging democratic institutions. On some occasions holding it back is useful, and we frequently do delay disbursement.

You can't say in every case that delaying disbursement is necessarily the approach that will achieve the end desired. I think we just have to stay very close to it and find the optimum way to handle it.

### JAPANESE ECONOMIC POWER

Mr. **Porter**. I have got macro question for you. There are those who observe the world scene today, and they come to the conclusion that the military power is no longer the power that directs the future of the planet because the United States and the Soviet Union have a standoff in nuclear capability, each can destroy the other, and that we are gradually changing over to economic power.

Economic power is lodged, of course, in the United States, as opposed to the rest of the world, but it is gradually shifting away from us as the Japanese come forward without spending very much of their GNP on military preparedness. While we and the Soviets are spending vast amounts, they are spending very little, and we are rapidly losing ground on the economic side to Japan. Japan is already past the Soviet Union in practically every economic measure except gross GNP. It is moving up rapidly on the United States. We are losing ground in the export markets, et cetera.

How do you look on this, and what do you think this means for the projection of American power in the future?

Mr. **Schneider**. Well, it is a very good question. I think it is the kind of question that is very useful for the Congress to address as it tries to decide how best to distribute resources. It is unquestionably true that economic power and influence are a decisive force in the world, and there is no doubt that the Japanese have been particularly effective in their economic development. I think in noting that ecomomic assistance or economic development, rather, is extremely important, in many cases maybe crucial, there is a certain conditional statement that has to be made with that, namely, that economic development can only take place in an environment where there is at least some measure of security.

One of the cross-cutting trends is that the evolution of military technology is also making it possible to disrupt economic development relatively cheaply, as the use of terrorism as an instrument with relatively inexpensive, but technically effective, means can undermine some of the best efforts of those seeking to encourage the development of economies.

So what our policy is trying to do, and maybe there are better ways to do it in detail, but in general the emphasis is to use security assistance to provide that modicum of stability around which the economic development process can be protected.

In terms of worldwide influence, one of the reasons why the Japanese can be effective in some sense in the world in which they live is because the United States, and to some degree other allies in the West, take upon themselves the major burden of providing this security shield. So I think the security dimension can't be disembodied from the economic side. I think they really are joined even if the economic side is given more prominence.

Mr. **Porter**. Let's make the Japanese pay more for the security.

Mr. **Schneider**. One of the things we are doing, Mr. Porter, is having discussions with the Japanese about getting them to substantially augment their economic assistance. They are providing aid in the Caribbean now and parts of Africa to pick up part of the burden we cannot carry.

Mr. **Porter**. They always seem to say yes, but go very very slowly.

Mr. **Schneider**. They are giving more economic assistance to the Philippines than we are at this point, and that goes for a few other areas, also. So they are not doing as much as we would like, but they are doing a lot more than they are given credit for.

Mr. **Porter**. Thank you very much.

Mr. **Obey**. Mr. McHugh.

Mr. **McHugh**. Thank you, Mr. Chairman.

## RESTRAINING THE FOREIGN ASSISTANCE BUDGET

Mr. Secretary, General, welcome again. You were here, Bill, earlier this week when the Secretary appeared before our subcommittee, and I know you heard the graphic message that the chairman delivered about the need for restraint in this particular budget, and I would simply like to reinforce that, because until the Administration and the Congress decide to raise some additional revenue to pay for commitments, we are not going to be able to expand this budget if domestic programs are going to be the focus of cuts to try to reduce the deficit. This will not be exempt.

I say that as someone who believes generally we should be implementing effective foreign assistance programs. Although we may disagree on particular aspects of its from time to time, I am not critical of foreign assistance in principle. But even I would be required to cutback on accounts that I support strongly until we deal with the total budget in a more realistic way, and to me that means at least raising some additional revenue to help pay for our essential needs.

So in that context, I would like to explore with you a few areas where we might have some questions, and it seems to me, as a practical matter, if there are going to be cuts in this part of the budget, it would be useful if your office and this subcommittee, among others, could try to join together in seeing if we can't reach some agreements on which priorities are most important.

## MILITARY AID FOR GUATEMALA

One of the requests that you have here, as I recall, is a MAP program in Guatemala. I think developments in Guatemala, and specifically the election of Mr. Cerezo, are very significant and positive; we want him to succeed and democracy in all of its forms to spread.

So I am prepared, in principle, to help in Guatemala. But Mr. Cerezo has been here and said he is not requesting military assistance, and yet the budget requests some MAP assistance for Guatemala, and here we are having to look for places to cut.

Isn't it sensible for us to scratch the MAP request for Guatemala in the context of our budget problem and in the context Mr. Cerezo, himself, saying he is not looking for MAP assistance at this time. If we provide help, shouldn't it be in the economic area where they have very pressing problems?

Mr. SCHNEIDER. There is some detail on that, Mr. McHugh, I would like to provide for the record, because it is on a classified basis.

Let me say, just as a summary characterization, we have been advised that assistance later in the year would be requested. Obviously, we are not going to force military assistance on a country that doesn't wish to have it, but I think you will appreciate, knowing as much as you do, about the situation in Central America and the situation we face in Guatemala, is we are coming off a well-entrenched military regime, and we want to be in a position to have the democratic regime the one that can deliver the goods to the military, that the military regime cannot get military assistance unless it is done under democratic auspices.

So, just separating out the question of the timing of the request, I think it would be a good idea for us to be able to respond favorably if they do request military assistance so that we can strengthen the hand of the democratic forces in the country against those who would undermine it.

Mr. McHugh. You will provide more details?

Mr. Schneider. I will provide more details, yes.

[The information follows:]

This information was provided during a classified briefing for the Committee.

### AID TO PAKISTAN

Mr. McHugh. Looking down the road prospectively and at the risk of engaging my friend, Mr. Wilson, in debate, I understand that you and Mr. McPherson will be going to Pakistan to discuss our aid program and that Pakistan is looking for a significant increase in aid. I am sympathetic to Pakistan and have supported past increases in assistance to that country. It is a front-line state, and it is playing an important role in the region. I am not antagonistic to Pakistan.

On the other hand, in the context of our budget problems and anticipating that we are going to continue to have them, at least for a few years, it seems to me that it would be unrealistic to promise not just Pakistan but any country increases in military or economic assistance in the context of what I perceive to be declining numbers, at least in the next few years.

I know your negotiations are not complete, but what do you anticipate with respect to Pakistan? Are we looking at a request for additional numbers? I suppose I would urge you to consult not just with this subcommittee but with other key Members of Congress before recommending something to the President, because we don't want to be in a position where the President is committed to an increase, and we are the bad guys having to cut back.

So I would hope that you consult with us and others and not put is in a position of where we have to reject a request, because that sends a signal we are not sympathetic, which isn't the case. I wonder if you could bring us up to date on these negotiations and what you anticipate.

Mr. Schneider. Thank you, Mr. McHugh. I think you have virtually made the kind of speech I have made within the Executive Branch. The Secretary is fully aware of the resource restrictions we face as well. Without getting into the details of the discussions specifically, it would be fair to say we do not anticipate a major increase in the aggregate size of the program. We recognize that the budget problems we are likely to face for the next several years will not permit a major expansion in resources for any country, and so this, I think, is now well understood by our friends in Pakistan.

I think they do have a good understanding now of our budget predicament, and I don't anticipate that the discussions with Pakistan will result in any serious problems. We have developed a profoundly good relationship with Pakistan now. I think the assistance the Congress has supported has strengthened the—not only our relationship with Pakistan but strengthened democratic forces within the country, improved their security and given their economy good prospects for a turnaround. So I think the program is successful, and we look forward to a successful post-1987 program.

### FMS DEBT REPAYMENT

Mr. McHUGH. I have about a minute or so left, so I don't have much time to get into this subject, but let me introduce it. I know your preliminary remarks may have touched upon this as well.

There are a number of tables I would like to include, without objection, in the record, from a GAO report on the FMS repayment problem. Those tables indicate a number of things. For example, they indicate that the total contingent liability to the United States Government over the next 30 years of FMS guaranteed loans would amount to some $58.7 billion.

They also indicate that as of September 30, 1984, $292 million was overdue. The trend toward even higher outstanding balances is growing. Egypt and Turkey are leading the list. The reserve fund used to protect against defaults by foreign governments on their FMS payments is rapidly being depleted.

The GAO, I think, recommended that the State Department use as a reserve a portion of the money we appropriate. I know the State Department has expressed concern about that approach because, from your perspective, there is limited enough money to go around as it is; if you have to set some of it aside in a reserve, it would exacerbate your problem, but nonetheless, if this reserve is going to be depleted in fiscal year 1987, which I think is the projection, we are going to be in a bind here.

I wonder if you can briefly address that, and given my limited time, which is about to expire, you may want to expand upon it in the record.

Mr. SCHNEIDER. I will expand on it for the record, but if I could make a couple of points. I think you have raised an important question. I think that the first priority that we should be addressing, though, is, we recognize that we have a very serious problem with prior FMS debt, but let's first focus on not making the problem much worse. And to this end we have requested over the past couple of years significantly more MAP, as the chairman has dwelled on the fact that the MAP account has had a very high growth rate, but that reflects the fact that we want to change the mix in the program, reduce the high cost-of-money loans, increase the concessional and grant component so that the problem for the recipients at least doesn't grow any worse.

The second question is how do we deal with the problem of prior-year FMS debts? As I said, we recognize the problem, we are looking at some ways to deal with it. I just mentioned one general consideration. It is true that the FMS debt is about $60 billion, but the worldwide commercial debt is on the order of $800 billion. We have to be very careful that a solution that we find to the FMS debt problem doesn't prejudice the way in which we deal with the commercial debt that would cause the situation to come unraveled.

So we have to do some, I would say, creative thinking to come up with some effective way. The Secretary is very mindful of this. We have had some discussions over the past several months with the

Treasury, trying to find some effective way in which we can balance all the equities. We haven't found a satisfactory answer yet, but we will certainly keep the committee posted.

Mr. **McHugh**. Thank you.

### FOREIGN ASSISTANCE LEVELS

Mr. **Obey**. Mr. Kemp.

Mr. **Kemp**. Thank you, Mr. Chairman.

I am sorry I wasn't here earlier. My colleague, Jerry Lewis, I know spoke for all of us, at least on the minority side, on complimenting you on the job you have done, and particularly in reference to your point that it is critical to our country's foreign policy to have and adequate level of funding for security assistance programs.

What that level is going to be is subject to the vicissitudes of congressional debate and priorities, but nonetheless, as I have been trying to point out to my colleagues, with not a whole lot of success in some quarters, it bears repetition, that this is a defense issue, critical to the free world and to our hopes of expanding democracy and peace and stability and freedon in the world. And our priorities, while important, domestic and defense programs, and the desire to get budget deficits down. Must not ignore the fact that this security assistance program has to be set with an eye also on the threat that we face and the opportunities that we face in the world.

Having made that a general premise, let me give my colleagues at least some good news, and if all of them aren't here, put it at least on the record.

### THE PHILIPPINES

In the Philippines we have seen some incredible and immediate manifestations of sound economic policy, and what it can do for an economy. Jaime Ongpin, the new Philippine Minister interviewed by the Wall Street Journal, the Asian Wall Street Journal, made a statement I know our Chairman would be interested in hearing. He wants to solve the enconomy's structural problems first. He wants to dismantle the farm monopolies and the crony capitalism. He wants to make the tax system fairer and lower and implement a land reform based upon the successful, not confiscatory Malaysian model, which is somewhat different than the El Salvador and Vietnamese models. When the aid money flows, he wants it to be made available to the private sector, not to the government.

In terms of equity capital for farmers, he suggest—that aid should not be channeled through government agencies that would abuse it for political gain.

I really look upon this with favorable reaction, because that in and of itself has strenghtened the Philippines peso; capital has stopped flowing out of the country; it is starting to come back in. The Philippine stock market, as weak as it was under the previous regime, has begun to climb.

Let's encourage these policies—those bases in the Philippines are critical to this country. One cannot look on the western Pacific and see, in my view, an alternative to Subic Bay, particularly with the

Soviets at Cam Ranh Bay and the Philippines at the adjunct of the Straits of Taiwan as well as the Straits of Malaca.

Jaime Ongpin, Joe Fernande, the re-appointed minister of the Central Bank, these appointments are favorable signs from the Aquino Administration that she wants to pursue market-oriented solutions.

This hearing is about security assistance, but I think it is very important to realize that the first order of securing our bases, if you will, and our alliances is economic in nature.

### IMPORTANCE OF ECONOMIC CONDITIONS

I brought this up with AID Director McPherson yesterday that more thought needs to be given to encouraging that global economic climate where our own bases and allies and friends can feel more secure and be more friendly to the United States and vice versa.

I hope this message is read by the State Department and we do encourage that, and we don't turn around and discourage it in our own hemisphere.

Mr. SCHNEIDER. I agree with you very much on this point, Mr. Kemp. The core of our bilateral economic programs have been to try to effect policy change. That is why we have not elected to follow the route that was taken in the 1970s of trying to have massive resource transfers and instead use the economic assistance we have to reinforce policy change, because there isn't enough money in Fort Knox to cope with bailing out countries that have bad economic policy, and I think this—the Philippine case is a good example. If they change the policies with the assistance we can make available, then we can go a long ways towards strengthening what they are trying to do and strengthening democratic order and make them a viable security partner for us.

### AID FOR KAMPUCHEA

Mr. KEMP. You have been a strong supporter of what we loosely, in de facto fashion, call the Reagan Doctrine of supporting freedom fighters, and supporting resistence to Marxist governments, countras or however these groups are labeled.

And to the Cambodia resistance or Kampuchea resistance Rep. Solarz last year was able to move through the Foreign Affairs Committee—

One of his efforts to get $5 billion for Kampuchea, I think we appropriated 3.5 million—is anything going to be done? Is the money in a reserve contingency fund?

As I understand, nothing has been done with regard to those moneys.

Mr. SCHNEIDER. I will have to provide for the record the expenditure plan for the funds allocated. I will provide it directly to you.

Mr. KEMP. With dispatch?

Mr. SCHNEIDER. Yes.

[The information referred to follows:]

### ESF for the Cambodian Non-Communist Resistance

Of the funds appropriated for ESF in the Continuing Resolution, the Administration plans to allocate $3.35 million to the Cambodian non-communist resistance forces. These funds will be administered in cooperation with the Government of Thailand. We plan to obligate the funds through an agreement with Thailand in April. We expect the funds will be used for non-lethal training and material assitance for the forces; other countries are providing sufficient weapons and ammunition. Final details of the program are still being worked out in Thailand. Details of the program will be provided to the Committee shortly.

### ANGOLA AND NAMIBIA

Mr. **Kemp**. Angola, let me ask you about a rumor, in fact, an article in the morning Post by Mr. Tyler and Mr. Ottoway about Assistant Secretary of State Crocker's new regional talks and what is coming out of those talks with regard to Namibia. It is rumored there is some agreement perhaps with MPLA to get the Cuban troops—some suggest up to 30,000 Cuban troops—out of Angola over a period of time. What does this mean to our efforts to aid Savimbi?

How do you view the situation right now as to Crocker talks and the possibility of reaching an agreement on an independent Namibia?

Mr. **Schneider**. I think it is fair to say we are at a critical juncture in the region, and certainly the question of an independent Namibia is not unconnected from events in Angola.

The South African Foreign Minister made a statement the other day about moving towards the question of independence for Namibia under the U.N. security council resolution 435. I think it still remains to be seen how precisely this will be coupled to the question of Cuban troop withdrawals and other issues there.

I think—because Mr. Crocker is still traveling on this subject, it is probably best if I provide the material that you are interested in for the record, because I haven't seen the cable traffic this morning.

[The information referred to follows:]

We have been actively engaged in negotiations with South Africa and Angola on Namibian independence and Cuban troop withdrawal from Angola. South Africa recently announced its readiness to begin implementing the UN independence plan for Namibia, Resolution 435, on August first, provided there is agreement on Cuban troop withdrawal. This is a significant step in the negotiations to achieve Nambia's independence, the withdrawal of Cuban forces from Angola and, more broadly, peace in the region.

An opportunity now exists for rapid movement toward a settlement, and we believe that this opportunity should be seized by all parties. Meanwhile, Cuban troops remain in Angola and massive Soviet aid continues. We thus continue to believe that appropriate and effective support should be provided to UNITA.

The Post article referred to Assistant Secretary Crocker's meeting in Geneva with Vladilin Vasev, a Soviet Foreign Ministry Africa expert. They discussed the entire range of problems in southern Africa and, particularly, the negotiations for Namibian independence. This meeting was held in accordance with the agreement, reached last November between President Reagan and General Secretary Gorbachev, to hold additional experts' discussions on regional conflicts.

Mr. **Kemp**. There seems to be a two-track effort in Central America to both pursue a negotiated settlement, although that is diminished in some people's eyes, but the Contadora process operates on one track and the Contras operate on a separate track.

They are both, hopefully, designed to put pressure on the Sandinistas to liberalize and stop their oppression of the Church, the press, their people, and again to get some of the East German, Bulgarian, PLO, Cuban advisers, quote, unquote, out of Nicaragua.

Why couldn't the same thing be done in Angola? Savimbi has mentioned he wants to raise the cost of foreign occupation of Angola until Cuba and the Soviet Union cannot bear the burden.

Why shouldn't we pursue the same track in Angola as we are attempting to do through this administration and State Department in Nicaragua?

Mr. Schneider. I wouldn't exclude doing that. I think the position of the administration can be described as intending to see that appropriate and effective support is provided to UNITA.

We share the widespread sympathy with UNITA's struggle with Soviet bloc and Cuban forces in Angola, but the details of exactly what aid should be provided and how it can be provided I think needs to be done in classified form.

### GRANT MILITARY ASSISTANCE

Mr. Obey. Mr. Wilson.

Mr. Wilson. Yes. I don't know if it would have to be provided for the record or not, but of our military assistance, how much of it, other than Egypt and Israel, how much of it is straight up grants?

Mr. Schneider. Less than $800 million. I think it is about $740 million actually provided in grants world-wide.

Mr. Wilson. How much of that goes to Egypt and Israel?

Mr. Schneider. They get a unique kind of grant, forgiven foreign military sales credits. Israel and Egypt, the only two countries that receive that.

Mr. Wilson. How much do they get?

Mr. Schneider. They get a total of about $2 billion—no, $3 billion, $3.1 billion in FMS credits forgiven and the rest of the world shares the remaining grant money, which is $740 million.

Mr. Wilson. Why do we call it different things?

Mr. Schneider. Well, it relates to the legal characteristics of the equipment that is provided. I think I should provide the exact details for the record for you on the legal differences between equipment provided under FMS versus under MAP, but there is a legal difference relating to the ownership of the equipment.

[The information referred to follows:]

### MAP and Forgiven FMS Credit Difference

Defense articles, whether granted under section 503(a)(1) of the Foreign Assistance Act of 1961 (FAA) or sold under the Arms Export Control Act (AECA), are owned by the recipient foreign government or international organization. However, the U.S. Government has reversionary rights under section 505(a)(4) FAA to items granted under section 503(a)(1) FAA if the items ar declared by the recipient to be no longer needed for the purposes for which furnished. No reversionary rights to defense articles sold under the AECA exist. Military assistance provided under section 503(a)(3) FAA does not involve the granting of defense articles, but simply the use of such grant funds to pay, in whole or in part, bills due under sales made pursuant to the AECA. As such, the U.S. Government retains no reversionary rights to any defense articles sold under the AECA for which some payments are made from MAP funds provided under section 503(a)(3) FAA. Similarly, sales made under the AECA and financed with direct credits or guaranteed loans (whether "forgiven" or repayable) are not subject to the reversionary rights provisions of section 505(a)(4) FAA.

Most MAP financed transactions are processed as sales under the provisions of section 503(a)(3) FAA because they can be administered within the same logistics and financial system as the Foreign Military Sales Program. This saves significant manpower effort within the Department of Defense. In most instances, therefore, programs financed by MAP and programs financed by forgiven credit are processed under identical procedures and carry identical provisions for end use and third-party transfer rights. From time to time, however, MAP funds are provided directly to Military Departments to finance programs under the provisions of section 503(a)(1) FAA. Although used sparingly, this method can be advantageous for the following reasons, none of which are possible under forgiven credit provisions:

Programs can be executed more quickly in emergency situations because there is no need for the country to accept an FMS letter of offer.

DoD controls entirely the content and transportation mode for transactions financed by this method.

DoD controls entirely when MAP funds will be disbursed under this method. Under FMS credit procedures (whether "forgiven" or repayable), the country involved must authorize payments by signature of a letter of authorization.

As indicated above, the USG retains reversionary rights to the material.

Although the proceeds of direct credits or guaranteed loans may be used to finance direct commercial contracts as well as sales under the AECA, section 505(a)(3) FAA restricts the use of MAP funds to financing only sales under the AECA.

Mr. WILSON. There is realistic or financial difference, though; they are airplanes, tanks or something they don't have to pay for, right?

Mr. SCHNEIDER. The end items are the same and they don't have to pay us back for it. But there is a difference in the legal characteristic of the ownership of the equipment, I believe. It is a legal matter and I will——

General GAST. If I may, sir, whether it is MAP or forgiven credit, it is placed into the trust fund and we disburse funds in other government's behalf.

On a forgiven loan such as Egypt and Israel, it just simply says they are forgiven for repayment back for their debts on the year it is appropriated only, not forgiven for the past.

Those funds are available for commercial purposes. If they are MAP funds, they are not available for commercial purposes. MAP must be used for FMA purchases.

Mr. WILSON. That is why Egypt and Israel have procurement offices in the United States. These funds become available to them to buy things?

General GAST. That is right. MAP must go through the FMS system versus commercial system.

Mr. WILSON. I would appreciate seeing that for the record.

Mr. SCHNEIDER. Yes.

[See page 284.]

## PAKISTAN

Mr. WILSON. On Pakistan, I want to say that I agree with Mr. McHugh, I think it would be a mistake, although they are enthusiastic and excited. Some of them thought that when they moved toward the democratic government, particularly in the civil area, the domestic area, they felt they would be rewarded. But I think since they have been over here, they recognize the constraints are such that we are not in a position to reward anybody and they won't get more assistance.

But Pakistan—is it not true that Pakistan is unique? Are there others? Pakistan has been a major FMS client for the last five years or six years.

Mr. SCHNEIDER. Six.

Mr. WILSON. Six. They are the only ones, or are they the only ones that have not received their FMS on a concessional basis of the major clients like Turkey?

Mr. SCHNEIDER. The Republic of Korea has also been receiving it on a non-concessional basis and they also have a large program. It has been about $230 million per year.

And Spain is another case which has been getting about $400 million a year. And Greece about $500 million a year.

Mr. WILSON. Those countries per capita income is much higher than Pakistan?

Mr. SCHNEIDER. Certainly Greece is and Spain.

Mr. WILSON. Greece has been getting theirs on a market basis and Turkey has been getting theirs on a concessional basis?

Mr. SCHNEIDER. Last year there was a change with respect to Greece where the Congress authorized a concessional program for Greece, but it doesn't include the entire amount of assistance provided.

Prior to that, the Greek program had been entirely on a non-concessional basis.

Mr. WILSON. When you get the final proposals for Pakistan this year, do you anticipate concessions?

Mr. SCHNEIDER. That is what I would like to do—I believe it is in Pakistan's interest to have a program, even if it were to be smaller to have it on a more concessional basis, because of the problems they are inevitably going to have just managing the debt they have already acquired at cost of money rates. But that is of course post-1988, the follow-on program.

The commitment we have through 1987 is for the conventional terms on FMS.

Mr. WILSON. I of course believe, and everybody knows I believe, I believe considering the intense pressure Pakistan is under from the Soviet Union and the intense burden they have with 350 million refugees, if anybody is due a little extra consideration, it probably is Pakistan. They are taking all the heat right now for that part of the world.

Mr. SCHNEIDER. Our problem has been generally a reluctance on the part of the Congress to appropriate as much concessional assistance as we have requested.

Pakistan initially didn't want concessional assistance, so that is the way we structured the program and that is the way the planning has been on a multiyear basis.

## FMS DEBT REPAYMENT

Mr. WILSON. Assuming Pakistan is able to pay, and I think this is something that has been of concern to the Chairman and certainly to me, but—do we really expect all of the FMS we are providing to countries like Turkey to be paid back?

Mr. **Schneider**. Yes, I believe so. In the case of, let's take a couple of big recipients like Greece, Turkey, Korea, all of them have good economic prospects.

Turkey has turned its economy around very substantially by good economic-policy. Greece is a relatively rich country; there is no reason why they can't pay it back. Israel, another country with a large FMS debt, has made a major turnaround in their economic policy, and economic growth is the raw material that will enable them to deal with the debt problem.

So there undoubtedly will be some countries that will not be able to cope with the problems.

Mr. **Wilson**. How much does Israel owe?

Mr. **Schneider**. They owe about——

General **Gast**. Their repayments are abut $900 million a year. I am not sure what that value is, but that is——

Mr. **Schneider**. We will supply it for the record, but they are the largest single FMS debtor.

[The information referred to follows:]

### How Much Does Israel Owe?

The outstanding FMS debt (principal and projected interest) for Israel at 30 September 1985 was $24.1 billion, of which $1.1 billion is repayable in FY 1986.

Mr. **Wilson**. Didn't Senator Cranston have some kind of bill to forgive all that?

Mr. **Schneider**. Not forgive it. He had language in the fiscal 1985 authorization that recommended the ESF program provide resources that were not less than the debt service that Israel had to meet.

Mr. **Wilson**. But that——

Mr. **Schneider**. It is not—the ESF——

Mr. **Wilson**. That didn't occur, did it? It didn't pass.

Mr. **Schneider**. It was in report. It is not requird by statute, but our program—ESF's program—exceeds the amount they have to repay anyway, so there is no consequence from it.

Mr. **Wilson**. Is the same thing true in Egypt's case? I assume it is.

Mr. **Schneider**. There is not the same kind of report language, but the repayment schedule they have is compatible with the ESF level.

Mr. **Wilson**. What about Pakistan?

General **Gast**. Their repayment annually is around $340 million.

Mr. **Wilson**. What is their ESF?

Mr. **Schneider**. About $200 million.

Mr. **Wilson**. Is there anyting, Mr. Chairman, we would like to have for the record on this debt and the ratio to ESF where we might ourselves make some sort of judgment as to who is going to pay it back and who is not.

Mr. **Obey**. Last year we had inserted in the record a whole series of charts showing what people's GNP—what each GNP was for a country. We put other information in the record comparing debt, comparing our aid level to GNP levels and other indexes.

I don't have any other questions that I would want to put in on that point, because I think last year's data holds.

ISRAELI BUY-DOWN PROPOSAL

Mr. WILSON. Have we gone back and forgiven anybody?

I thought we did some for Israel, Egypt, where we went back and forgave some prior FMS debt. Is that true or not?

Mr. SCHNEIDER. No, Mr. Wilson, we haven't forgiven any debt.

Mr. WILSON. We haven't done anything that——

Mr. SCHNEIDER. Not forgive prior action. There was an initiative taken in the Senate side last year that was not subsequently supported in conference, or I think it was not supported on the floor either.

Mr. OBEY. That was taken off.

Mr. SCHNEIDER. It was taken off by Senators Inouye and Kasten——

Mr. OBEY. The full committee.

Mr. SCHNEIDER. You are correct. It was not supported in full committee to provide additional ESF to pay off additional portion of the prior year debt.

Mr. WILSON. For whom?

Mr. SCHNEIDER. For Israel. As I say, it was not approved. It would have resulted in an additional $500 million.

Mr. WILSON. So we have never—I mean in recent history we have never fogiven FMS because the country couldn't pay it?

Mr. SCHNEIDER. That is correct. The policy we have in dealing with FMS debt is we don't consider any single kind of debt to be separate from the total debt of the country involved, and so if a country has a problem repaying it goes into the so-called Paris Club and the rescheduling is done for all of the debt as a whole, not just FMS debt.

Mr. WILSON. Do you anticipate any recipient now having problems repaying such as—you said Turkey is in good shape.

Mr. SCHNEIDER. I think Egypt is continually struggling with the FMS debt problem.

Mr. Wilson. Theirs was granted on a concessional basis?

Mr. SCHNEIDER. They did better than that. Now it is on a full-grant basis, FMS credits——

Mr. Wilson. The debt in jeopardy was concessionary?

Mr. SCHNEIDER. No, most of what they have—in fact, all of the debt they have incurred was a cost of money loans to the Treasury. That is one of the reasons why the debt to them is high cost and it is a difficult burden. They have the added burden, unlike Turkey and some of the other countries that have gotten hold of their economic policy, they are still struggling with the problem of an economic policy that forces on their budget very high costs for subsidies and things of this sort that inhibit their ability to provide resources to meet their debt needs.

Mr. Wilson. At this time, would you explain once more——

Mr. OBEY. Last question.

Mr. Wilson. ——Senator Kasten and Inouye proposes? I never understood that.

Mr. SCHNEIDER. The concept they had was a so-called buydown which was to provide additional ESF resources to in effect reduce the interest rates they had to pay from the average of around 10 or 11 percent down to 5 percent, so if the loan that would have come due in fiscal 1986 would have been—had to be paid back at a 5 percent rate rather than a 10 or 11 perent rate on the books. To do that, the so-called buydown for a single year was $500 million.

Mr. Wilson. That would have been just added to the foreign aid bill?

Mr. Schneider. Yes.

Mr. Wilson. The administration did or did not support that?

Mr. Schneider. We couldn't support it because the budget ceiling was such that it would have come out of the rest of the world.

We already were facing a——

Mr. Wilson. We never got that out of the House, did we?

## FMS DEBT BURDEN

Mr. Obey. We didn't get it in the House. We made it quite clear if we didn't get it, it wouldn't get very far given the circumstances we are facing.

Let me just say on this question, I think anybody who has followed it knows that you have a whole lot of smoke and mirrors in the room when you are discussing this issue, because there are a lot of countries who I am convinced are as close to the edge as they have ever been in terms of their ability to repay. I think from conversations I have had with people in both the Executive and Legislative Branches, we understand sooner or later we may have to deal with that problem generically.

The objection that we had last year was if you did it for Israel, you were opening up the flood gates to at least $9 billion of similar debt for which people ~~would ask that~~ we support the same buydown provision, and we would have been, I think needless to say, laughed off the floor if we tried to do that at the same time we were passing Gramm-Rudman.

I think, Charlie, there is no question in my mind that down the line we are going to have to—I don't care what euphemisms we want to call it, whether it is rescheduling or any other new words we can invent for the dictionary—we are going to be faced with the necessity to do something about it for a number of countries.

The debt has been so large for so long, unless you have miracle in the Third World, we are going to be facing that.

Mr. Obey. Go ahead.

## THE THREAT TO SOUTH KOREA

Mr. Mrazek. Thank you, Mr. Chairman.

I was wondering, General, if you could give me a little more detailed analysis of how you would describe the military threat in South Korea?

General Gast. The threat has been growing substantially.

Mr. Mrazek. Since?

General Gast. Over the last five years and it continues to grow. The Soviets have shown a willingness to provide later technology in high-performance aircraft into North Korea. The readiness status of the North Koreans is indeed very high. They exercise a great deal.

The concerns, I believe as I would see it and as the Koreans see it are the tremendous pressure they are being placed under and they are concerned with the upcoming Asian and Olympic Games as well.

Mr. **Mrazek**. Why would the Olympic Games themselves be an important factor as far as our——

General **Gast**. They are concerned about terrorist acts such as happened in Burma.

Mr. **Mrazek**. Isn't that more a responsibility of the Olympic Committee itself?

General **Gast**. It is the responsibility of the host country as well.

Mr. **Mrazek**. Do you have a general estimate of what the present cost of the 40,000 troops we are maintaining in South Korea is?

General **Gast**. I am sorry I do not have that. I will get it for the record.

[The information to be furnished follows:]

[**Clerk's note**.—The Department provided the following response:]

Insert requires research and will be classified. Will be forwarded to the committee as soon as available.

Mr. **Mrazek**. Do you think it is in excess of $10 billion a year? Would you know, Mr. Schneider?

Mr. **Schneider**. No, I don't believe it is that expensive because dealing mainly with the incremental cost of deployment in Korea and the Korean Government provides about a billion dollars in support costs for the U.S. deployment there, so the net cost, net incremental cost would not be anything like that.

We will provide it for the record. I don't have it at my fingertips, but I don't believe it is anything like that.

Mr. **Mrazek**. Mr. Schneider, when the South Koreans are put in jail for circulating a petition to have a popular election take place for the president of the country, does that concern you?

Mr. **Schneider**. Yes.

Mr. **Mrazek**. How would that concern manifest itself in terms of our commitment?

Mr. **Schneider**. As we have worked in other environments, it is a delicate matter. We take diplomatic initiatives to try to persuade our friends to undertake a more democratic path to governance. I think the record has shown that we are fairly successful at it.

Mr. **Mrazek**. Do you anticipate there will be increased progress in terms of the recognition by the present government that perhaps the idea of circulating a petition in favor of a popularly elected president might be somewhat allowed?

Mr. **Schneider**. I think over time we will be able to encourage Korea towards a democratic path. The fact that, as General Gast pointed to, the people in South Korea have a massive military threat less than 40 miles from the area where two-thirds of their GNP is produced which has produced strains that have adversely affected democratic development.

However, our policy in the country is to encourage and stimulate economic development, and that is what we will continue to do.

## SOVIET AID TO NORTH KOREA

Mr. **Mrazek**. General, would you view Mainland China, Communist China, as a significant component and threat we are facing as far as North Korea goes?

General **Gast**. I would not, no, sir.

Mr. **Mrazek**. So the Soviet Union represents the key support threat.

General **Gast**. That is right, sir.

Mr. **Mrazek**. That threat presently consists of shipments of upgraded weapons?

General **Gast**. Yes, sir; new aircraft.

Mr. **Mrazek**. Military advisors?

General **Gast**. Principally military aircraft and contributing to the industrial capability to produce their Korean arms.

Mr. **Mrazek**. Hypothetically, if the Soviet Union were not actively involved in support of the North Koreans' military, how would the South Koreans, without American assistance, handle themselves in a conflict with the North?

General **Gast**. Considering what they have, I think that it is our commitment, having our forces there to insure they are not attacked, to deter an attack.

Mr. **Mrazek**. I understant that. That is a very expensive deterrent financially for us. I am curious what your assessment would be if hypothetically the North Koreans and South Koreans faced off in the future.

General **Gast**. That is difficult to say. I would say the risk would be considerably higher if we were not there to offer the deterrence.

Mr. **Mrazek**. That wasn't exactly my question.

General **Gast**. I understand that. The forces are significant and they would make serious inroads into the territory

Mr. **Wilson**. Why is that South Korea has a larger population and larger industrial base?

General **Gast**. But they don't have the larger number of forces and a larger number of tanks. The North Koreans, with assistance from other, have been able to devote far more of their resources to the Army, the South Koreans have put a great deal into their economic development.

Mr. **Mrazek**. They have a pretty strong economic future, don't they?

General **Gast**. Yes, sir.

Mr. **Mrazek**. The Republic of Korea troops themselves are fairly well trained and committed, aren't they, as well?

General **Gast**. They are very well trained, yes, sir, but not in the same numbers or the same number of aircraft, tanks or ships or anything.

## SOUTH KOREA'S DEFENSE BURDEN

Mr. **Schneider**. If I could add a footnote to that, there is an important element here that gives the South Koreans a somewhat more difficult defense burden because of the fact the North Koreans operate at an extremely high level of readiness and most of the South Korean GNP is in the area within a very short distance of the 38th parallel where the North Korean forces are deployed, the need to have very substantial forces to prevent a massive, even short-term penetration into this area that would destroy their economy is a critical reason as to why the South Koreans need our assistance.

We provide not only the troop deployment in terms of ground forces, but the tactical air power that contributes to deterring this kind of massive surprise attack which the North Koreans appear to be in a state of readiness to carry out.

Mr. **Mrazek.** It wasn't too long ago we were primarily concerned about the Chinese-supported attack of the same nature against the South, and according to General Gast, that no longer appears to be a serious——

Mr. **Schneider.** One of the changes in the political situation there is that the North Koreans have come to depend more on their own indiginous resources. They have built up an industrial base and have undergone a very massive armament program and kept a large fraction of their population under arms and operating at a high level of readiness and have come to depend more on the Soviets than the Chinese. They share a border with both countries.

The situation has changed over the past 15 or 20 years that has caused us to change our policy.

General **Gast.** I might add, sir, as far as North Korea, 20 percent of their GNP goes to military readiness versus 6 percent for South Korea, which is substantial itself in the South.

Mr. **Mrazek.** The South, though, doesn't it have three or four times the GNP of the North?

General **Gast.** They have somewhat more, of course, but still in the number of units that are maintained, their operational readiness is not the same.

### THE SEOUL OLYMPICS

Mr. **Mrazek.** I want to make it clear for the record I don't underestimate the threat that is posed by the North Koreans to their neighbors in the South. But it seems to me that perhaps 6 percent GNP committed towards their own defense might be rather small considering the stake that we all have in South Korea and considering our own domestic budget problems. Certainly adequate thought must be given to exactly what our future commitments ought to be with regard to South Korea. I keep hearing the Olympic Games represent a serious potential threat. I am just curious, do you think we ought to be responsible for maintaining the security of the International Olympic Games no matter where they are held in the world?

Mr. **Schneider.** It isn't a question of us providing security. The reason the Olympic Games are an important issue there is that the North Koreans view the holding of the Olympic Games in South Korea as an important political event that somehow bestows worldwide legitimacy on the Republic of Korea.

So the North Koreans have alluded to threats against the staging of the Olympic Games there and as a consequence a concern that exists in the Republic of Korea is the fact the North Koreans might use the occasion of the buildup to the Olympics to either initiate terrorist acts or some other form of hostility in an effort to prevent the Olympic Games from being held and thus withdrawing the sort of worldwide recognition of the Republic of Korea as a full-fledged modern state.

So that is the critical character of the Olympic Games. It is not a question of us providing security.

Mr. **Mrazek**. We don't have any real responsibility to improve their capability to protect themselves from potential terrorist acts?

Mr. **Schneider**. The South Korean forces are providing the protection for the Olympic Games itself. It is the question of the occasion of the buildup to the Olympic Games that may be a cause for the initiation of military operations against the Republic of Korea that we are endeavoring to try and maintain Korean military strength.

Mr. **Obey**. The gentleman's time has expired.

Mr. **Mrazek**. Thank you.

### DEFENSE OF THE WESTERN PACIFIC

Mr. **Obey**. Mr. Kemp, do you have a quick question?

Mr. **Kemp**. I apologize, I have to go to a Budget Committee meeting so I am going to have to leave. I know you haven't had a chance to question the witness. I really have just one last observation in listening to my colleague and my friend from New York, Mr. Mrazek, talk about the South Korean situation.

I was surprised a little bit, Bill, that you and the General did not go beyond South Korea and talk about the cost—or what the potential cost would be to this country—in terms of the forward defense perimeter of the Western Pacific with regard to the possibility of ever having that type of a war again. It was a big mistake, it seemed to me in past U.S. policy, without looking at names or administrations who have drawn a defense perimeter, that did not include in the Western Pacific, South Korea. The cost to this country of the Korean War was staggering, and I am not suggesting Mr. Mrazek has called for anything other than commitment to the freedom of the Western Pacific, and I know no one interprets it as such. But I think in terms of your trying to sell a defense-oriented security assistance package to the United States Congress, we have got to convince the American people they have a big stake in this foreign aid bill.

I am responsible on the Republican side for trying to get conservatives who hate foreign aid to vote for it, and economic development and security assistance, and of dealing with all of the various trade proposals that are coming up.

It seems to me it is essential we do a better job of convincing the Congress and the American people that they have a vital interest in what happens, not just in the Pacific Basin, but in our hemisphere, et cetera.

I was disappointed, frankly, that you did not bring up the fact that we have constitutionally made it impossible for Japan to rearm. So absent any rearming of Japan, the one area of Asia that we are actively involved in for the defense of the Western Pacific is South Korea and I don't see how Japan can stay where they are vis-a-vis East-West relations—I am talking about Soviet-U.S. relations and such a friend of the United States, irrespective of our complaints now and then—without our presence in the Pacific and what it saves us in defense and manpower costs and other costs.

Mr. SCHNEIDER. You are correct, and I was remiss in not going into that.

As you recall, in the late seventies we had quite a debate in the Congress over the proposals made by President Carter to withdraw U.S. forces from Korea, and the Congress, many, including yourself I know, are quite active in the congressional efforts that succeeded in getting that decision reversed.

Historically the fact that Korea was once declared outside of our defense perimeter undoubtedly contributed to the fact that we had to engage in hostilities there, so I think it is correct that we have a longstanding interest in security in Korea.

### A POLITICAL COMPROMISE

Mr. OBEY. Mr. Schneider, General, in light of your response on that last comment, let me just make a couple observations.

Getting back to my original point, I think we are going to wind up, unless we do have the kind of political compromise right at the top I have been talking about, unless everybody from the Pentagon to social program supporters recognize that we can't continue with the public getting a dollar's worth of program for every 79 cents we pay in taxes; unless they are willing to pay for what they want, you are going to be facing, General, questions about which troops you want to withdraw and which weapon systems you want to empty or forget and which countries you want to cut off from the support list. Because I mean it with dead seriousness, I have absolutely no intention of producing a bill out of this committee which does more than provide for aid for the Middle East at Gramm-Rudman levels for 1987 and which provides at most a billion dollars on the economic side and a billion dollars on the military side, because I can't pass anything bigger than that. In fact, I honestly don't think I can pass that.

I seriously question whether I can pass anything on the floor except Middle Eastern money because we have an obligation this year, General, I don't know if you are familiar with it, but in the past we followed these bills into a continuing resolution, this year Gramm-Rudman requires us to have the foreign aid bill out on that floor.

I am not trying to harass you. I am trying to make certain people downtown understand where we are at. We don't have a snowball's chance in hell of passing a foreign aid bill unless it is cut dramatically, as long as we are seeing a $73 million reduction in cancer research, $62 million reduction in heart disease research, $31 million reduction in AIDS research, and one quarter of a million reduction in student aid in the country; job training cut by 17 percent; transportation cut by $5 billion, agriculture cut by $8 billion, soil conservation being cut by 30 percent, rural water and sewer being cut by 100 percent; HUD-assisted housing being cut by 100 percent, UDAG by 100 percent, elderly and handicapped housing loans cut by 100 percent.

### THE FOREIGN ASSISTANCE REQUEST AND GRAMM-RUDMAN

I am sorry but when I look at your statements and when I see you, Mr. Schneider, say on page 1 of your testimony that within an overall budget package, we believe it is fully consistent with the Gramm-Rudman-Hollings deficit reduction limitations, the security assistance programs are presented for your consideration, I just have to tell you, given the fact that the CBO itself questions your overall military budget baseline, in general I notice you've got the same kinds of statements in your testimony on three separate occasions suggesting this is consistent with Gramm-Rudman.

It is not consistent with Gramm-Rudman in the eyes of 90 percent of the Members I have talked with on both sides of the political aisle, and I don't mean to be discourteous and dismiss your testimony and suggest that it isn't important, but I tell you we can't pay any attention to it unless somebody in the White House and the leadership of both Houses pay attention to our point, which is if we don't have a compromise, if we don't have the general outline of a compromise, which I fundamentally believe has to have increased revenues, we are simply not going to be able to produce a bill that is anything less than a shadow of its former self, and that means at least a 50 to 60 percent cut in this bill.

I don't like that, but I am the messenger. It is my responsibility to make people understand what the facts of life are before we get into these crunches.

One other thing on that and then I will hush up.

General, you are asking that we provide additional flexibility, you are asking for a two-year lease rather than the one-year lease on some of these programs so that you can plan. I have to point out—I recognize the legitimacy of that, but on the domestic side, let me point out we have some programs which are forward-funded for precisely that same reason.

So that people know what the shape of those programs are going to be down the line, school boards need to know, for instance, before they get into their budget year, what is happening.

The President's budget suggests that—it suggests rescinding $1 billion in funds already appropriated for forward funding programs on the domestic side, compensatory education for the disadvantaged, education for the handicapped, some vocational education programs.

The Corporation for Public Broadcasting, a $14 million rescission is proposed.

I happen to oppose the forward-funding for that item because I believe everybody ought to be in the pit annually fighting like hell because that is the only way you can get people to understand what the consequences are if we don't get the overall budget worked out right. I don't like to have certain groups in this society exempted from having to sweat a little to participate in that democratic process, but again I lost it and made a decision on forward funding, and it is going to be hard to say—as you request on the last page of your testimony, General, "to insure continued improvements in the force structure of our allies and access for U.S. forces overseas; and to cope with conflicts, including terror and radical aggression—will have to be confronted with new flexibility to offset severe budget restraints" under Gramm-Rudman and when you call in the previous program for enhanced reprogramming flexibility to offset the rigidity of Gramm-Rudman-Hollings, I simply have to tell you, I voted against it, I led the opposition to it, but the Administration, which you represent today, insisted that we pass it, and so, by God, as far as I am concerned, the folks who insisted it ought to be passed in the first place are the folks we ought to insist live up to it.

I voted against a $5 billion supplemental for agriculture in my own congressional district, and I have got a lot of farmers. I voted against that in order to convey a message to anybody watching that I am deadly serious on this bill.

As far as I am concerned, the bill we bring out of here you and I will both regard as totally inadequate in terms of our obligations, but unless your boss agrees we have got to cut the baloney and start explaining to people if they want your programs and all the others they are going to have to accept a revenue increase, then you have to accept the logical consequences of that position, which is cut the program because it is the least popular program, not the least important to my view, or I wouldn't be in this chair, but the least popular program.

## TRUCK STANDARDIZATION IN EL SALVADOR

Let me ask you some questions.

El Salvador. One goal of U.S. military aid is to improve the Salvadorans' military mobility. As part of that goal, the U.S. has attempted to standardize the Salvadoran vehicle fleet and create a logistical system built around a single manufacturer's equipment and spare parts for each transportation requirement, as I understand it.

Is the Administration agreeing to a Salvadoran procurement of a second supplier of trucks?

General GAST. We have, as you say, Mr. Chairman, attempted to focus into a common logistic system, because logistics become very important to them as they absorb equipment.

Mr. OBEY. You also don't want them ripped off.

General GAST. We try to handle this as much as we can. We are very careful about approving contracts. You may be referring to an instant case where they are looking for some additional vehicles and perhaps you are referring to the funds that you agreed we should expend on antiterrorism, procuring those for their police forces.

Mr. OBEY. Are you agreeing to a Salvadoran procurement of a second supplier of trucks, is my question?

General GAST. For trucks, I really don't know. I would have to provide that for the record. I don't recall particularly.

Mr. OBEY. I would like that.

[The information to be furnished follows:]

Yes. We recently agreed to finance the purchase of trucks for the El Salvador public security forces from a second supplier. This contract was closely reviewed. It was the lowest bid of five received.

General GAST. If I might add, in looking for the vehicles we have attempted to find the least expensive vehicles as well, and in many cases these vehicles are rebuilt trucks that have come out of old inventory no longer useful to us. And in some cases we go with that group——

Mr. **Obey**. Let me be blunt. We have had a lot of problems in terms of corruption with regard to El Salvador in the past and one of the reasons for having one supplier is to avoid someone slipping in for their unfair share of U.S. tax dollars.

General **Gast**. I am very mindful of that.

Mr. **Obey**. That is why we are very sensitive when we hear rumors some deal may be set up to set up a second supplier, we——

General **Gast**. I can assure you that in each case, whether it is a sole-source request or it is a commercial procurement, that we go through those contracts very carefully and we call in the people to justify the prices.

Mr. **Obey**. If you are considering a Salvadoran procurement of a second supplier for trucks, would that reverse the standardization program and require the building of a second logistical system?

General **Gast**. It would not. We have generally been able to provide those spare parts within a single logistic system, and we would not see setting up a separate one for that.

Mr. **Obey**. I have two other questions for the record I would like to submit on this, and move on to some other questions.

[The questions follow:]

### El Salvador—Military Logistical System

Mr. **Obey**. If the Administration agrees to a Salvadoran procurement through a second supplier of trucks, will this reverse the standardization program and require the building of a second logistical system?

Answer. No. This will not reverse the standardization program. These trucks are being supplied to the El Salvador Police, and they already have a logistical system in effect.

Mr. **Obey**. What is the cost of this second logistical system?

Answer. No additional costs will be required since a second logistical system is unnecessary.

### SPECIAL DEFENSE ACQUISITION FUND

General **Gast**. Mr. Chairman, may I just briefly respond to your——

Mr. **Obey**. Absolutely.

General **Gast**. I wanted to clarify what we are asking for. This is fore the special defense acquisition fund. We are not looking for forward funding.

Mr. **Obey**. I understand that. You are looking for more flexibility.

General **Gast**. Only so we don't have to rush to obligate the funds we are authorized to obligate in only one year, that is all.

Mr. **Obey**. I understand the merits of that, but when we are running into all kinds of technical glitches under Gramm-Rudman that screw up our ability to deal with housing on the same grounds, that screw up our ability to deal with education so that school boards don't have to put their blasted budgets together twice. I tell you, if we are asked to make adjustments for you, but through reprogramming, for instance, but we are supposed to live under this for programs we fought and died for for ten years, no dice.

We are all going to be in the same boat or nobody is going to be in the boat. Them's my views.

### MILITARY AID INCREASES

Let me ask you on MAP assistance, again, when Jerry Ford was President, we were assured that grant MAP assistance was going to be phased down to zero and we were going to get out of the business of giving, we were going to be in the business of trying to get people on their own feet and looking at loans.

We had a lot of things happen, and for years I kept asking why those numbers were going up, why were the countries getting ESF, getting MAP—they said you have to understand, we have this big explosion in oil prices that changed the world, it means we can't live up to our own proposals, that is legitimate.

Now oil prices are coming down dramatically. That means, I would think, that if we increased MAP and some other programs because they coudn't afford anything, it ought to be for a lot of countries they are going to have a windfall and they ought to be more able to pay for some of what they are getting. Yet since 1981, the number of countries receiving ESF funding has gone from 21 countries to 47.

On MAP, we have from 5 to 38; on IMET training from 63 to 97 countries. you are adding new MAP programs in Burma, Colombia, Equador and Peru. I understand the importance of all those.

Mr. Shultz pointed out the drug problem in Burma. My question is, don't these lists ever get shorter? What I see here is—I believe what I see is an attitude that almost amounts to country-by-country entitlements and once you are on the list, by God, it takes a miracle and an earthquake to get somebody off the list.

When are we going to get that list shrinking? When are you going to show you have had to make the kinds of choices which I am being asked to make in my other Subcommittee on Labor and HEW instead of simply finding a new need, adding it to the list without pulling the plug on people whose needs aren't quite as high?

### THE EFFECT OF DECLINING OIL PRICES

Mr. SCHNEIDER. You have raised quite a few points in your remarks, Mr. Chairman. If I may just address a few of them briefly.

First, with respect to the question of oil prices, oil prices did have a profound effect on the economies of many countries in the mid- and late seventies, and the ESF assistance and other forms of economic assistance we were able to provide at the time facilitated their ability to adjust to it, but as they have adjusted to it in some cases new problems have arisen.

Take the case of Egypt as just one example of a country that in some ways benefits from lower oil prices, in other ways is hurt by it. They are hurt by it because Egyptian nationals who work elsewhere in the Arab world are unable to send remittances back that depress their economy.

Mr. **Obey**. I understand there are some countries that are clobbered, Mexico, Egypt, Nigeria and a number of others, but my point is for the vast majority of Third World countries who have no oil, I mean does it only change on the upside? Why does the rationale change—why does the argument for oil prices, which this Administration used to the hilt in order to justify MAP increases, now that you have got oil prices cut in half from the 31 bucks that they were just a short while ago, why don't we see this list not cut in half, maybe why not a quarter?

Mr. **Schneider**. The question of the impact of changes in commodity prices like that is not necessarily so much that they are higher or lower, it is often the rate of change that will be the equilibrating factor. After a period of several years at a higher level of oil prices, the structure of their economy, the pricing of their goods and so forth will adjust to it, but the situation is more complicated.

You take a country like Kenya, sure it doesn't have oil, but some of its products are sold to countries that are oil producers. When they can't import Kenya's products, then Kenya's economy suffers even though they may benefit in other ways from lower oil prices.

It is a complicated process. The NSC is now doing a study of the effects of lower oil prices and we are trying to get a better understanding of exactly how it cuts.

### CUTTING MAP

Mr. **Obey**. Would you give me a list of the countries you would knock off the MAP program if MAP were cut in half this year?

Mr. **Schneider**. No, I am afraid I can't do much in that arena because we believe that the MAP requests we have made are essential to our interests.

Mr. **Obey**. Well, in that case, you want us to make the choices rather than you.

Mr. **Schneider**. The way in which the committee has operated recently has, I would have to say, made putting the budget together a pretty low morale activity—

Mr. **Obey**. It is for a lot of people on the domestic side, too.

Mr. **Schneider**. I can just tell you from where we sit we spent six months putting the budget together and working on the details of country programs to face a process which deals only with aggregates and doesn't address any of the specific country questions.

Mr. **Obey**. You oppose the aggregating requirement. You told us we had to pass it. You were willing to disinvest the social security trust fund which required us to say the hell with everything except aggregates.

When I tried to so something about that, I got booed.

Mr. **Schneider**. The administration has submitted a budget that meets the Gramm-Rudman aggregate—

Mr. **Obey**. It is off by $15 billion.

Mr. **Schneider**. I had some time at OMB in the early 1980s, I know the question of outlay estimate is at best an arcane line of work.

Mr. **Obey**. I also know when the Pentagon submitted their estimate of current services budget, that it was $16 billion difference from the number provided by OMB when OMB got around to giving us an estimate of the current services for the same program.

So I don't think it was a programmatic change; I think it was a political change to phoney up the numbers to be blunt about it.

Let me ask—

Mr. YATES. OMB would do that?

## BASE RIGHTS REPORT

Mr. OBEY. Base rights, last year the committee directed in its report the administration should report to us by February 2nd on its plans for the next round of negotiations on aid levels to each base right country that could take place between now and 1989.

When are we going to get that report?

Mr. SCHNEIDER. I will have to find out. Just a second.

They are in the last stages of finishing it. It should be up shortly, Mr. Chairman.

Mr. OBEY. We are going to mark this up the end of May. If I don't have that report by then, I don't see how we can have any money.

I have three other questions I want to put in on base rights questions at this moment.

[The questions referred to follow:]

### BASE RIGHTS REPORT

*Question.* Last year the committee directed in its report that the Administration was to report by February 2, 1986, on "its plans for the next round of negotiations on aid levels to each base rights country that could take place between now and 1989". Why hasn't that report been submitted? When do you anticipate submitting the required report?

Answer. In coordination with the Department of Defense, we have prepared a report which puts the question of such negotiations into the context of our on-going security assistance relationships with base rights and certain access rights countries, and of our overall national security policy. Specifically, the report reviews the terms of treaties/agreements we have with these countries, describes the Administration's plans for any upcoming negotiations with these countries, indicates current and projected security assistance levels, and projects — to the extent possible — costs to replace the capabilities we gain through these base and access rights arrangements. It took somewhat longer than we had anticipated to develop this information. The report was transmitted to the committee on April 4.

[CLERKS NOTE.—The report follows:]

**United States Department of State**

*Washington, D.C. 20520*

APR 4 1986

Dear Mr. Chairman:

The attached documentation is provided in response to the Committee's request last year for information regarding the levels of assistance and future negotiation plans for countries which allow us base rights or other access to military facilities. The information includes the thirteen countries where the focus of the U.S. security assistance relationship, as delineated in the FY 1987 Congressional Presentation for Security Assistance Programs, is to enhance cooperative defense and security relationships, including maintaining base and/or access rights. The information is unclassified except for an addendum which is classified SECRET.

As requested, this information describes the Administration's plans for any upcoming negotiations relating to the continuation of various basing and access agreements with these countries. In light of constantly changing political and security conditions, it is difficult to project definitively the state of our future relations with every country with which we have such agreements, and the priority we will place on the continuation of these arrangements. Nevertheless, we have attempted to project our negotiating plans to the extent possible for all the countries involved.

The Department of Defense has supplied rough estimates of the costs to replace in another country the military facilities currently available to the United States in the base rights countries. In addition, the DOD has supplied for the base rights countries and many of the access arrangement countries estimates of the cost of replacing the existing infrastructure in the same country in which the facilities are now located.

Determining the cost of replacing the facilities in another country or, more to the point, the cost of replacing the capabilities provided by existing facilities is a complicated procedure. Replacement estimates more detailed than the rough estimates provided in this document would involve many variables and require an exhaustive and lengthy analyltical effort for each

The Honorable
David R. Obey,
Chairman, Subcommittee on Foreign Operations,
House of Representatives.

country. Meanwhile, the Department of Defense has underway a detailed study of alternatives to existing U.S. bases in the Philippines which will be submitted to the Congress when completed.

Sincerely,

James W. Dyer

James W. Dyer
Acting Assistant Secretary
Legislative and Intergovernmental Affairs

## BASE RIGHTS AND ACCESS ARRANGEMENTS

The following reviews the terms of treaties/agreements with a group of base rights and access countries, describes the Administration's plans for any upcoming negotiations with these countries, indicates current and projected security assistance levels, and estimates - to the extent possible - costs to replace the capabilities we have through these arrangements. This report includes the thirteen countries where the primary focus of the U.S. security assistance relationship, as delineated in the FY 1987 Congressional Presentation for Security Assistance Programs, is to enhance cooperative defense and security relationships, including maintaining base and/or access rights.

### Base Rights countries
(Greece, Philippines, Portugal, Spain, and Turkey)

Arrangements with base rights countries generally include a "best efforts" pledge or understanding on security assistance levels. These pledges/understandings do not constitute "rental agreements". The extent to which we are able to meet the terms of these arrangements affects the degree of cooperation we receive on the operational level and the parameters of the wider security relationship.

It is not necessarily the availability of a foreign base which establishes our security assistance program for these countries. U.S. interests derive from key factors such as a country's external threat, strategic location and financial need for assistance. In many areas of the world, we have stationed substantial forces in strategic locations but offer no security assistance owing to the strong economy of the host country.

### Access Arrangement Countries
(Djibouti, Kenya, Liberia, Morocco, Oman, Panama, Somalia, and Sudan)

In arrangements for access to facilities, we generally have not included figures or pledges of "best efforts" for security assistance. The explicit compensation in the arrangements themselves often was an undertaking to improve or construct host country facilities to meet US contingency requirements.

Replacement Costs

The Department of Defense has supplied rough estimates of the costs to replace in another country the military facilities currently available to the United States in the base rights countries. In addition, the DOD has supplied for the base rights countries and many of the access arrangement countries estimates of the cost of replacing the existing infrastructure in the same country in which the facilities are now located.

Determining the cost of replacing the facilities in another country or, more to the point, the cost of replacing the capabilities provided by existing facilities is a complicated procedure. Replacement estimates more detailed than the rough estimates provided in this document would involve many variables and require an exhaustive and lengthy analytical effort for each country. In some cases there are inherent and unique geographic advantages to a given location which no alternative foreign site can duplicate. In such cases, the principal "costs" of relocation would not be financial, but strategic and political: a derogation of US defensive and power projection capabilities, including the ability to come to the assistance of key allies such as our NATO partners and Israel. To the extent, however, that we sought to compensate for the loss of an overseas facility by changes in our force structure, e.g. increased mobility assets, there would be a significant financial outlay as well.

Where the geography and other physical and technical characteristics of an alternative foreign location -- and political realities -- do offer capabilities roughly parallel to those provided by a current site, the probable costs go much beyond the price of replacing buildings and other infrastructure. Among the factors that have to be taken into account are land acquisition costs, costs for moving personnel and equipment, comparative adequacy of the labor force for base operations and comparative local wage scales. In addition, since it is unlikely that the alternate site would duplicate in every respect the strategic advantages provided by an existing location, there could be additional expenditures required to accommodate these differences, e.g., longer steaming and flight distances would translate into more fuel consumption and higher operations and maintenance costs.

Finally, in any alternate site negotiations, the prospective host government might well consider that base rights or access would serve its national interests only if these arrangements reflect a broader security relationship with the United States. This, in turn, could entail or imply some U.S. contribution of resources to assist in meeting host country defense needs.

It should be noted also that, while most of the relocation costs referred to above would be unrecoverable expenditures of U.S. funds, a large portion of the Security Assistance which we have furnished to the base rights countries listed (our programs with the access countries are relatively small) has taken the form of Foreign Military Sales credits at Treasury rates. As discussed in this year's Congressional Presentation for Security Assistance Programs, these are monies which not only are expended in the United States with resulting benefits to the U.S. economy, but are repaid with interest and represent an eventual profit transaction for the U.S. Treasury.

## GREECE

In Greece, we have access to air and naval facilities and training and communications sites. The current DECA between Greece and the United States is in effect for an initial five year period through December 1988. It will remain in effect thereafter unless terminated by either party with five months notice. In connection with the signing of this DECA in 1983, we confirmed to the Greeks that we would request $500 million in FY 1984 assistance from Congress. There is no pledge figure for current fiscal years. We do not know at this time whether there will be negotiations for a new DECA. Nor do we know whether or how aid levels might be a factor in such negotiations.

As in the case of the other NATO recipients of security assistance, security assistance levels are linked not only to the bilateral cooperative arrangements in effect, but to Greece's military responsibilities and needs within the Atlantic Alliance. Greece has vital responsibilities with regard to defense of NATO's southeastern flank. Its strategic position in the eastern Mediterranean, astride major international shipping lanes, makes Greece an important communications and transportation link for U.S. and NATO forces.

Estimated in situ facilities replacement cost: $250 million. Estimated cost to replicate existing facilities in other countries, probably Italy and Turkey, is between $750 million to $2 billion. Relocation would involve rebuilding the infrastructure for four major facilities plus numerous small sites.

Security Assistance Levels
($ millions)

| | 1985 (Actual) | 1986 (Request) | 1986 (Post-sequester) | 1987 (Request) |
|---|---|---|---|---|
| ESF | -- | -- | -- | -- |
| MAP | -- | -- | -- | -- |
| FMS (T) | 242 | 500 | 83.546 | 500 |
| FSM (C) | 258 | -- | 347.104 | -- |
| IMET | 1.366 | 1.75 | 1.244 | 1.75 |
| Total | 501.366 | 501.75 | 431.894 | 501.75 |

## PHILIPPINES

In the Philippines we have access to important air and naval installations which enable us to counter growing Soviet presence in this strategic region. Without our access to the Philippine bases, the perception of the superpower balance in Southeast Asia by our friends and allies in the region would change dramatically, to the detriment of our considerable interests in the Pacific. Our presence in the Philippines is based on the Military Basing Agreement(MBA), which has been reviewed two times within the last decade. As a result of the 1979 review we agreed to further review of the MBA every five years. The next session is scheduled in 1988. In the initial agreement, which ran 1980-1984, we agreed to seek to provide the Philippines $500 million in security assistance. In the second agreement, 1985-1989, we agreed to make our "best efforts" to provide $900 million in security assistance. In light of recent political developments, we are reexamining our overall relationship, including our assistance policy, with a view to determining how best to promote both our specific defense interests and our interest in democratic and economic progress in the Philippines.

Estimated in situ facilities replacement cost: $2.25 billion. Estimated cost to re-establish the existing air and naval facilities on Guam or other sites in the northern Marianas range from $10 to $15 billion, given the distances required to move the extensive air and naval operations.

Security Assistance Levels
($ millions)

| | 1985 (Actual) | 1986 (Request) | 1986 (Post-sequester) | 1987 (Request) |
|---|---|---|---|---|
| ESF | 140 | 95 | 119.625 | 95 |
| MAP | 25 | 50 | 38.28 | 50 |
| FMS (T) | -- | -- | -- | -- |
| FMS (C) | 15 | 50 | 14.355 | 50 |
| IMET | 2.167 | 2.25 | 2.105 | 2.75 |
| Total | 182.167 | 197.25 | 174.365 | 197.75 |

# PORTUGAL

The U.S. concluded an agreement in December 1983 which extended U.S. rights and access to Lajes Air Base in the Azores until 1991. We committed ourselves to making our "best efforts" in assisting Portugal in the modernization of its armed forces. Portugal is of considerable strategic importance because much of the West's maritime traffic passes through the Atlantic triangle bounded by mainland Portugal, Madeira, and the Azores. Base facilities in the Azores are vital for NATO reinforcement, anti-submarine warfare operations, and out-of-area operations. In 1984, the US and Portugal exchanged notes authorizing construction of a ground based electro-optical deep space surveillance (GEODSS) station in southern Portugal. This station, for which Portugal provided the land, will allow the tracking of potentially hostile satellites.

In the foreseeable future our proposed assistance for Portugal will take into account the significant contribution to US capabilities that these facilities make as well as Portugal's role as an active and committed member of NATO and its specific needs to fulfill NATO force requirements.

Estimated in situ facilities replacement cost: $500 million. The unique location of Lajes Air Base establishes that facility as practically irreplaceable and its loss would result in the need for a substantial increase in numbers of refuelable strategic airlift aircraft and tanker aircraft support.

Security Assistance Levels
($ millions)

| | 1985 (Actual) | 1986 (Request) | 1986 (Post-sequester) | 1987 (Request) |
|---|---|---|---|---|
| ESF | 80 | 80 | 76.56 | 80 |
| MAP | 70 | 70 | 66.99 | 75 |
| FMS (T) | 55 | 30 | 9.57 | 21.5 |
| FMS (C) | -- | 35 | 33.495 | 45 |
| IMET | 2.959 | 3 | 2.297 | 3 |
| Total | 207.959 | 218 | 188.912 | 224.5 |

## SPAIN

The U.S. concluded an agreement with Spain in 1982 for U.S. rights and access to extensive air, naval, and support facilities. We pledged our "best efforts" to continue to obtain funding at the then current level of $400 million FMS and $12 million ESF. The agreement has a nominal termination date of 1988 but can remain in force on a year to year basis if both parties agree.

Spain plays a key role in NATO defense strategy as the guardian of the entrance to the Mediterranean. In the event of hostilities, Spain would be crucial as a secure rear area for reinforcement and staging for forward deployed forces. Peacetime use of the Los Bardenas Reales air-to-ground combat range allows the U.S. Air Force to train in an area with good weather and low population density - a combination not available in Northern Europe.

In a joint communique issued in December 1985, the U.S. and Spain agreed to begin discussions on reductions of U.S. forces in Spain. Any such reductions would assume that the Spanish military would take over those missions no longer performed by U.S. forces.

Estimated in situ facilities replacement cost: $1.55 billion. Estimated cost to build four similar facilities in other countries range from $6 to $8 billion.

Security Assistance Levels
($ millions)

| | 1985 (Actual) | 1986 (Request) | 1986 (Post-sequester) | 1987 (Request) |
|---|---|---|---|---|
| ESF | 12 | 12 | 11.484 | 12 |
| MAP | -- | -- | -- | -- |
| FMS(T) | 400 | 400 | 382.8 | 400 |
| FMS(C) | -- | -- | -- | -- |
| IMET | 2.926 | 3 | 2.297 | 3 |
| Total | 414.926 | 415 | 396.581 | 415 |

# TURKEY

In Turkey, we have access to airfield installations and intelligence and communications facilities. The initial five-year term of the U.S.-Turkey DECA ended on December 18, 1985. The agreement, however, remains current on a year-to-year basis, unless terminated by either party. In September 1985, the Government of Turkey requested consultations on the DECA, and the U.S. and Turkey are now conducting discussions. Both sides have agreed that there is room for improvement in U.S.-Turkish cooperation and that ways should be found to strengthen it. The Turks are concerned about the intrusion of "extraneous factors" into the bilateral relationship such as the 7:10 ratio on security assistance, which they perceive as a limiting factor on U.S. assistance.

At the beginning of the current DECA (1980), the US pledged to exert its "best efforts" to obtain defense support for Turkey in accordance with mutually agreed programs. While US assistance has increased over the last 5 years, we believe the levels are insufficient to meet the modernization requirements of the Turkish armed forces. In addition to supporting Turkish facilities for US forces, our proposed assistance levels supplement Turkey's consistent and significant allocations of national resources to improve military capabilities and fulfill its commitments as a southern flank pillar of NATO's strategy of deterrence and defense. Turkey fills a critical role as the anchor of NATO's southeastern front, facing a longer border with a Warsaw Pact country than any other member of NATO. Turkey guards the Turkish Straits and serves to deter Soviet aggression through the Transcaucasus into Southwest Asia.

Estimated in situ facilities replacement cost: $850 million. To reconstruct in another country in the area the extensive air installations and facilities presently in Turkey would probably cost $4 to $6 billion.

Security Assistance Levels
($ millions)

| | 1985<br>(Actual) | 1986<br>(Request) | 1986<br>(Post-sequester) | 1987<br>(Request) |
|---|---|---|---|---|
| ESF | 175 | 150 | 119.625 | 150 |
| MAP | 215 | 230 | 205.755 | 220 |
| FMS (T) | 235 | 210 | 79.288 | 145 |
| FMS (C) | 250 | 345 | 330.165 | 455 |
| IMET | 3.59 | 4 | 3.158 | 4 |
| Total | 878.59 | 939 | 737.991 | 974 |

## DJIBOUTI

The U.S. has no formal agreement concerning military access rights with the Republic of Djibouti . However, as a result of prior informal arrangements with France - subsequently confirmed with the independent Government of Djibouti, we regularly enjoy access to Djibouti's facilities for naval ship visits, fueling stops, and P-3 flights. This access is important because of Djibouti's strategic location and our need for facilities for rest and transit in the area. Without access to Djibouti, the Navy would be required to use tankers. In addition, the Navy makes about four port calls a year in Djibouti.

To date, the Government of Djibouti has not been interested in a formal agreement. We are confident access will continue as long as we sustain adequate levels of economic and military assistance and the French have no objection. We estimate that approximately $8 million in annual assistance is needed to maintain this access.

Security Assistance Levels
($ millions)

| | 1985 (Actual) | 1986 (Request) | 1986 (Post-sequester) | 1987 (Request) |
|---|---|---|---|---|
| ESF | 3.5 | 5 | 3.35 | 5 |
| MAP | 2.5 | 2.5 | 1.914 | 3 |
| FMS (T) | -- | -- | -- | -- |
| FMS (C) | -- | -- | -- | -- |
| IMET | .126 | .125 | 0.096 | 0.15 |
| Total | 6.126 | 7.625 | 5.36 | 8.15 |

# KENYA
(See Addendum)

As one of America's closest friends in Africa, Kenya plays a critical role in our security strategy in Southwest Asia and the Horn of Africa. Kenya permits U.S. military access to its airfields and ports, providing repair and resupply facilities to U.S. aircraft and ships. Kenya also provides the primary liberty port available to U.S. vessels on the African littoral of the Indian Ocean. Its moderate policies and market-oriented economy make Kenya a key African nation from the U.S. viewpoint, and enable it to play a leading role in regional diplomacy.

U.S. security assistance is designed to ensure continued U.S. access to Kenyan facilities and to encourage Kenya to maintain its current open society and liberal economic policies. Because of reductions in overall appropriations levels, U.S. assistance to Kenya has been considerably reduced in the FY - 1986 allocation process. Our long term access goals in Kenya may be undercut if we are unable to restore FY - 1987 security assistance to a level approaching that of previous years.

Security Assistance Levels
($ millions)

| | 1985 (Actual) | 1986 (Request) | 1986 (Post-sequester) | 1987 (Request) |
|---|---|---|---|---|
| ESF | 25 | 35 | 14.355 | 22 |
| MAP | 20 | 25 | 19.14 | 20 |
| FMS (T) | -- | -- | -- | -- |
| FMS (C) | -- | -- | -- | -- |
| IMET | 1.693 | 1.8 | 1.627 | 1.8 |
| Total | 46.693 | 61.8 | 35.122 | 43.8 |

# LIBERIA

The U.S. has access to important airfield and communications facilities (including the largest VOA transmitter in the world) in Liberia that support our broad foreign policy and security goals. Our assistance promotes political stability and economic and social progress, and supports the overall climate of bilateral relations that are conducive to the continued presence of these facilities. We have no plans to conduct any negotiations with Liberia concerning military bases or access to military facilities between now and 1989.

Security Assistance Levels
($ millions)

| | 1985 (Actual) | 1986 (Request) | 1986 (Post-sequester) | 1987 (Request) |
|---|---|---|---|---|
| ESF | 43 | 48 | 28.71 | 40 |
| MAP | 12 | 13 | 4.785 | 8 |
| FMS (T) | -- | -- | -- | -- |
| FMS (C) | -- | -- | -- | -- |
| IMET | 1.157 | 1.3 | 0.981 | 1.4 |
| Total | 56.157 | 62.3 | 34.476 | 49.4 |

## MOROCCO

Our agreement with Morocco was signed in 1982 for an initial term of six years. It will continue in effect unless terminated by either party with two years notice. There was no side agreement on security assistance levels, but continued access which is determined on a case-by-case basis is dependent in part on our responsiveness to Morocco's assistance needs. Our agreement permits use of Moroccan facilities by the U.S. in contingencies and for training. Currently, we have a large exercise program in Morocco and are exploring other avenues for security cooperation. A stable, militarily capable Morocco as a pro-Western force for moderation in the Arab world serves U.S. national interests.

Estimated in situ facilities replacement cost: $35 million

Security Assistance Levels
($ millions)

| | 1985 (Actual) | 1986 (Request) | 1986 (Post-sequester) | 1987 (Request) |
|---|---|---|---|---|
| ESF | 15 | 22.5 | 11.484 | 20 |
| MAP | 40 | 45 | 33.495 | 60 |
| FMS (T) | -- | -- | -- | -- |
| FMS (C) | 8 | 5 | 0.957 | 10 |
| IMET | 1.479 | 1.85 | 1.435 | 1.85 |
| Total | 64.479 | 74.35 | 47.371 | 91.85 |

# OMAN

Our access agreement with Oman is reviewed every five years and was last reviewed in 1985. Under this agreement, the U.S. has limited peacetime and contingency use of certain Omani military facilities. After 1990, the agreement can be terminated with one year's notice by either party. At the time the agreement was negotiated, the U.S. recognized the heavy stress that Oman placed on economic cooperation. Our security assistance program to this strategic Arabian Pennisula country contributes to the modernization of Omani forces to defend against regional threats, promotes regional stability, and enables Oman to participate in collective security efforts within the Gulf Cooperation Council. It also supports our access arrangements for key Omani military facilities.

Because of its location, Oman is of considerable strategic importance. Over half of the western industrialized world's imported oil passes through the Strait of Hormuz. Shipping channels in this Strait are inside Oman's internationally recognized territorial waters. Of the Gulf states, only Oman has publicly supported the establishment of the U.S. Central Command. Peacetime military cooperation between the U.S. and Oman includes the use of certain facilities, including storage, support for the U.S. Navy's Indian Ocean battle group, and participation in periodic joint exercises. Because of reductions in overall appropriations levels, U.S. assistance to Oman has been considerably reduced in the FY - 1986 allocation process. Our long term access goals in Oman may be undercut if we are unable to restore FY - 1987 security assistance to a level approaching that of previous years.

Estimated in situ facilities replacement cost: $250 million

Security Assistance Levels
($ millions)

| | 1985 (Actual) | 1986 (Request) | 1986 (Post-sequester) | 1987 (Request) |
|---|---|---|---|---|
| ESF | 20 | 20 | 9.57 | 18.8 |
| MAP | -- | -- | -- | -- |
| FMS (T) | 40 | 58.3 | 19.14 | 40 |
| FMS (C) | -- | -- | -- | -- |
| IMET | 0.155 | 0.15 | 0.144 | .205 |
| Total | 60.155 | 78.45 | 28.854 | 59.005 |

## PANAMA

Security assistance provided to Panama is not an explicit condition of any base/access agreement. Under provisions of the Panama Canal Treaties and agreements and notes associated with the treaties, defense sites and areas of military coordination were established which continue for the life of the treaties, unless otherwise noted. The treaty with the defense provisions expires on December 31, 1999. After that date continued base rights/access to Army, Navy and Air Force installations as may be required would be subject to negotiations. Such negotiations are not envisioned between now and 1989. In a 1977 note regarding Economic and Military Cooperation, the U.S. agreed to seek to provide a total of $50 million in foreign military sales credits during the first 10 years of the treaties. The specific purpose of the funds is to assist Panama in developing those capabilities to assume primary responsibility for defense of the Canal by year 2000.

Security Assistance Levels
($ millions)

| | 1985 (Actual) | 1986 (Request) | 1986 (Post-sequester) | 1987 (Request) |
|---|---|---|---|---|
| ESF | 20 | 40 | 5.742 | 28 |
| MAP | 10 | 18.4 | 3.828 | 9.8 |
| FMS (T) | -- | -- | -- | -- |
| FMS (C) | -- | 4 | 3.828 | 4 |
| IMET | .589 | .65 | 0.574 | .75 |
| Total | 30.589 | 63.05 | 13.972 | 42.55 |

## SOMALIA

In August 1980, the United States and the Government of Somalia signed an agreement permitting United States military forces access to Somali airfield and port facilities. This agreement has an initial duration of 10 years and will remain in force thereafter until terminated by one year's notice by either party. Airfield and port facilities at Berbera are used for naval patrol flights and for U.S. military use in exercises (USCENTCOM conducts annual exercises) and contingencies. The Defense Fuels Supply Center maintains a fuel supply in Somalia. The agreement promotes regional stability by enhancing Somalia's ability to defend its independence and territorial integrity.

In the course of negotiating the Somali access agreement, the U.S. assured the Somali Government that we would provide substantial assistance to Somali armed forces. We do not envision early renegotiation of our access agreement, although the Somali Government frequently requests higher levels of U.S. military assistance, noting that higher levels would be consistent with our current security relationship. Because of reductions in overall appropriations levels, U.S. assistance to Somalia has been considerably reduced in the FY - 1986 allocation process. Our long term access goals in Somalia may be undercut if we are unable to increase FY - 1987 security assistance to a level approaching that of previous years.

Estimated in situ facilities replacement cost: $55 million

Security Assistance Levels
($ millions)

| | 1985 (Actual) | 1986 (Request) | 1986 (Post-sequester) | 1987 (Request) |
|---|---|---|---|---|
| ESF | 30 | 35 | 22.01 | 30 |
| MAP | 33 | 40 | 19.14 | 35.6 |
| FMS (T) | -- | -- | -- | -- |
| FMS (C) | -- | -- | -- | -- |
| IMET | 1.132 | 1.5 | 1.101 | 1.55 |
| Total | 64.132 | 76.5 | 42.251 | 67.15 |

# SUDAN
(See Addendum)

Sudan is of strategic importance to the United States because of its location and its political interests in, and ties to, the Middle East and Southwest Asia. Sudan extends valuable support to U.S. military deployments to the region and provides access for U.S. ships and aircraft. Sudan's most critical problem is its chronically weak economy.

U.S. economic assistance helps Sudan maintain international solvency and access to external credit. The U.S. security assistance program is designed to help modernize the Sudanese armed forces by providing training, logistics support, engineering equipment, light armor, and air defense. The government of Sudan is in the process of arranging for elections following the recent change of government. Following the reductions necessitated by the FY 86 allocation process, the USG would like to return to assistance levels which would adequately address economic and military needs of Sudan as it makes a transition to democratic civilian government.

Security Assistance Levels
($ millions)

| | 1985 (Actual) | 1986 (Request) | 1986 (Post-sequester) | 1987 (Request) |
|---|---|---|---|---|
| ESF | 114 | 115 | 59.812 | 90 |
| MAP | 45 | 58.5 | 19.14 | 50 |
| FMS (T) | -- | -- | -- | -- |
| FMS (C) | -- | -- | -- | -- |
| IMET | 1.43 | 1.75 | 1.148 | 1.75 |
| Total | 160.43 | 175.25 | 80.1 | 141.75 |

## INCREASED ASSISTANCE FOR BASE RIGHTS COUNTRIES

*Question.* The FY 1986 report also calls on the Administration to realize that increases in aid for base rights countries cannot be sustained, and that new agreements should reflect the fact that the U.S. will face serious budget problems. What are you doing to carry out the committee's recommendations?

Answer. Each of the base rights agreements contains language that commits the USG to undertake its "best efforts" to provide certain levels of security assistance. Our security assistance funding requests have always reflected those "best efforts" levels. Negotiations, at various levels, are now under way with Spain and Turkey to renew defense agreements and we shall keep the Congress informed of the results.

The negotiations are being carried out with an awareness on all sides of U.S. budgetary constraints. However, both Spain and Turkey are NATO allies who, consistent with their NATO roles and obligations, are undertaking extensive force improvements, including the acquisition of U.S. aircraft and other costly U.S. equipment. These modernization efforts, a large portion of which are funded by repayable FMS loans, would not be possible without our assistance. Thus, apart from their relationship to base agreements, U.S. programs for Spain and Turkey make a direct and vital contribution to enhanced Western defenses.

*Question.* The Administration indicated that our base rights agreement with Turkey could help the U.S. in contingencies that affect either NATO or the Persian Gulf region. However there is a question as to whether or not Turkey would allow U.S. bases to be used in any circumstance other than a NATO emergency.

Answer. Under existing agreements the use of U.S. facilities in Turkey is limited to NATO purposes. Nevertheless, Turkey has allowed — and we believe will continue to allow — U.S. bases there to be used in circumstances other than a NATO emergency. For example, we used the facilities there for transit and refueling in support of the U.S. contingent in the Multi-National Force during the Lebanon crisis.

*Question.* Last year, the Committee expressed concern about remarks made by the Prime Minister of Greece, Mr. Papandreou. What has occurred during the past year to improve Greek-U.S. relations?

Answer. There has been a number of developments in the past year which have improved Greek/US relations, most recently, of course, Secretary Shultz's visit. One welcome change has been the improvement in the overall tone of Prime Minister Papandreou's remarks about the U.S. Greece has improved airport security and has participated in the U.S. anti-terrorism assistance program. We remain concerned regarding the future status of our bases in Greece, and as the Secretary indicated, will have further discussions with the GOG. With regard to military cooperation, we took a major step forward with the notification of the Congress in February of the sale to Greece of 40 F-16 aircraft, and we have signed a GSOMIA (General Security of Military Information Agreement). In the wake of the Secretary's visit, we are optimistic that progress in our relations will continue.

*Question.* I also note that the third base rights issue raised by the Committee concerned the Philippines and the serious problems "rampant corruption and human rights abuses that exist there". Now that changes have occurred in the Presidency what approach are you taking in terms of security assistance?

Answer. A team of senior U.S. officials, including defense experts, visited Manila in mid-March to discuss with President Aquino and here ministers how the U.S. might be of appropriate assistance in helping the new government meet the serious challenges facing the country, including the threat posed by the communist insurgency. The team noted significant progress being made by the Aquino government both on the economic and military fronts. The administration now is considering ways in which we can assist President Aquino in her efforts to build a viable economy, as well as to develop a strong, professional armed force.

*Question.* Last year we had an extensive hearing on the issue of assistance to base rights countries. I asked you (Secretary Schneider) if there are any base rights or base access agreements that legally commit the United States to a specific dollar level of actual assistance. You answered, "To the best of my knowledge, no. The nature of the commitment is as I described, a best efforts commitment".

Your statement refers to "commitments" the Administration has made in negotiating overseas military base and facilities agreements. Do you still stand by your testimony of last year that there are no binding agreements to base rights countries?

Answer. Yes, I do. We make "best efforts" commitments because we know, and the base rights countries know, that we in the Executive Branch do not have the authority to commit the Congress to fund future programs. At the same time, we do try to reassure these countries that the United States continues to place a high priority on the strategic value of the bases and that we will endeavor to attain our joint objective of strengthening the host country's security and our mutual security, by the provision of military and economic aid.

*Question.* The Administration has proposed a $387.3 million increase in assistance to the 5 primary base rights countries. This represents a 19% increase in funding over the FY 1986 funding level, bringing base rights assistance from $1.9 to $2.3 billion. In a time of tight budget restraints, why have you increased funding to base rights countries by $387 million?

Answer. The levels of assistance which we have chosen for the base rights countries, as in the case of all other proposed recipients, are based upon our best estimate of the military threat and the needs and priorities of the countries involved. While the total of our FY 87 proposals for these five countries may represent a 19% increase over the FY 86 allocation level, it is slightly less than 2% over our FY 86 request, with country program increases proposed only for Turkey, Philippines and Portugal. Many programs each year are underfunded due to budget constraints. Such underfunding is not a justification for subsequent year reductions, when the military requirement continues to be valid and pressing.

*Question.* Specifically, why do we need to provide more than $400 million in military assistance to Spain, which is a developed country and a member of NATO? Does the increase in funding for Spain relate to any changes in base agreements?

Answer. Spain is deeply involved in a modernization program for its armed forces which includes ASW frigates, the F-18 fighter program and other hardware identified in the CPD. In addition it is seeking to increase its own capability to undertake essential functions now performed by U.S. forces. U.S. security assistance contributes to this effort, supports Spain's ability to increase its contribution to Western defense, and encourages bilateral and multilateral defense cooperation. We have not requested an increase in levels for Spain above that requested in FY 86.

*Question.* Similarly, why do we need to increase U.S. assistance to Portugal by almost 19% over last year?

Answer. While our total FY 1987 security assistance request for Portugal is about 19% greater than the amount allocated for FY 1986, it is less than 3% above our FY 1986 request. This proposed level of assistance is needed in order to help Portugal support the heavy military burden it bears in relation to its national resources. With one of the lowest per capita incomes of our European allies, Portugal contributes importantly to NATO. In addition, the proposed military assistance level is consistent with the "best efforts" pledges we made to Portugal as part of the 1983 base rights agreement.

*Question.* Is there any end in sight in assistance being provided to Turkey and Greece? (In fact Turkey is the largest country increase in the entire FY 1987 Foreign Assistance request!)

Answer. Turkey and Greece bear major responsibilities for the defense of NATO's southern flank. Turkey faces a longer border with a Warsaw Pact country than any other member of NATO. Confronting a massive military threat from the Warsaw Pact, Turkish forces are handicapped by insufficient resources and obsolete weapons and equipment. By our own estimates, billions of dollars in assistance are required to properly equip and train these forces. Our request reflects our estimate of the minimum of what is needed to meet Turkey's defense needs and sustain U.S. interests in this key region. In the case of Greeze, we have sought no increase in the levels of assistance above that requested and provided prior to FY 86.

Mr. OBEY. Let me stop here because I know Mr. Yates hasn't had a chance to question.

### RECAPTURING MARCO'S WEALTH

Mr. Yates. I have one question. I have been listening to your discussion with Mr. Schneider about stringency of funds and I wonder after reading Mr. Schneider's remarks about providing funds to help the Filipino people, and of course we want to do that. Do you propose to do anything to try to recapture for the Filipino people any of the amounts of money given to the Government of the Philippines which appears to have traveled with Mr. Marcos?

Mr. SCHNEIDER. Work is under way now in the regular processes of international law, and our agreements with the Philippines will be followed, and that may well result in recovery.

Mr. YATES. Can you tell us what this is? When you say the regular processes, what is being done?

Mr. SCHNEIDER. We have agreements with the Philippine Government regarding dealing with Philippine nationals who commit crimes or otherwise conducted activities against the interests of the Philippine Government, and there are ways—if these things are validated—for the Philippine Government to reclaim them.

Mr. YATES. It raises an interesting question. What kind of oversight do you exercise or did you exercise in the Philippines if in fact—we don't know this to be true yet—if in fact the money has been taken over by the leader of a country? Would you know about that? What kind of oversight did you have in the Philippines. For example, to make sure that the billions of dollars that Mr. Obey had given you for the Philippines came into the proper use?

Mr. SCHNEIDER. In general, our assistance doesn't leave the—was not provided in the form of cash. For example, our military aid to the Philippines goes into a trust fund and it is kept in the United States, orders are placed with the companies who produce the defense products, and they are paid out of the trust fund. So the Filipinos do not get any cash through the military aid program.

Mr. YATES. Is what you are saying, then, the rumors that foreign aid funds followed Mr. Marcos can't possibly be true if the procedure you just stated is an accurate rendition of what happens?

Mr. SCHNEIDER. Certainly there is no military aid that would go out that way, because it is not provided in cash.

Mr. YATES. What about economic assistance?

Mr. SCHNEIDER. Economic assistance is largely provided on a project basis through AID. That is, the project is funded with U.S. assistance, but there are few countries with whom we provide cash assistance, but I would refer the detailed response on the economic side to AID.

Mr. YATES. If your trust fund is so effective and fraud-proof, why wouldn't it be equally desirable to do the same on the economic side?

Mr. SCHNEIDER. Well, the nature of the programs are inherently different. On the military side, we are generally delivering a piece of military hardware or military service, like training or something like that, whereas on the economic side, we may have been delivering technical assistance, for example, in the agricultural sector or health care, something where the product has to be delivered in the country, and it may be working through a governmental entity in order to deliver the service.

So there is a basic difference in the character of what we are providing that makes a difference.

Mr. YATES. For military assitance, you would work with no Philippine governmental entity providing military assistance?

Mr. SCHNEIDER. We would provide the product itself, that is, the tank or the vehicle or whatever, to the Philippine armed forces, but they would not ever get their hands on any cash to procure the equipment. That would all be handled by our own people.

Mr. YATES. Thank you, Mr. Chairman.

Mr. **Obey**. Thank you.

### FUNDS STILL IN THE PIPELINE

General, you already mentioned this somewhat in your testimony, you referred to the pipeline question, why we shouldn't think that is a lot of loose money sitting there.

I have two questions I want to put to you for the record on this point, and then I want to ask you one here.

If you can give me some rough idea, I would appreciate it; if you can't, just stick in the record, but we need it soon.

What are the balances for countries where there is a commitment for funds, but the funds remain unobligated?

General **Gast**. I want to be sure that I use terminology that you and others would understand. I would like to use the term "committed" rather than "obligated." Uncommitted means that we have not financed letters of offer through the FMS system nor have we financed a commercial purchase, and the amounts in those terms then are roughly today about $2.2 billion as I recall, and I will give you a firm estimate—of which 1.3 is Greece.

The reason for Greece is because they have been holding the money until they have made a decision on a new fighter, tanks and artillery. For many other countries, the reason they are not committed is because the funds became recently available, they have plans to use them on a program. But many countries do not make a decision on precisely what to procure until they find out how much money they are going to receive in terms of financial assistance.

As I indicated during my presentation, in traveling from country to country, many of them have had to scrap their procurement plans and we and they together will go back and reevaluate and review them.

Mr. **Obey**. The reason I asked is because I recognize that while that may be in spirit committed, again we are not living in normal times, and I think the committee is going to want to take into consideration how much is not tied down in trying to figure out how we can deal with this problem over a two-year basis rather than taking a terrific reduction in one year's——

General **Gast**. I might add, in many of the countries you see listed here, relatively small amounts where our estimates were, the sale was somewhat less and they will immediately apply them, too.

Mr. **Obey**. I am not sure what the distinction is you are drawing. I recognize generically funds may be committed, but may not yet be obligated for a specific purpose.

General **Gast**. Financing in DSAA administered programs are obligated prior to commitment to particular procurement financing. I would be delighted to discuss that with you further and provide that interpretation.

### AID TO LIBERIA

Mr. **Obey**. Question on Liberia. The House passed on February 18th a resolution favoring a number of conditions on Liberia on economic aid and a suspension of military assistance.

The administration is requesting a security assistance increase, ESF, by 39 percent, and a larger increase for MAP. At the same time, the administration is proposing a decrease in development assistance.

Since everyone, starting from the White House, is in the business of doing analogies with the Philippines these days, we have got an analogy between those two countries in terms of the way they regard election results.

Tell us why we should, in light of that experience, be providing that country with an increase in military assistance even though they have done, albeit on a smaller basis, some of the same things Mr. Marcos appears to have been doing in terms of jimmying the democratic processes.

Mr. SCHNEIDER. The situation is Liberia does have certain parallels, as you mention. In another sense, each country is unique and has certain characteristics that are not replicated in others, even though there may be certain parallels.

One parallel I do think is important that sometimes is overlooked, as Members expressed their concern about developments that have the effect of thwarting democracy, is in looking at the Philippine case, the military was the key instrumentality in ultimately turning the Philippines in a democratic direction.

The situation in many developing countries is similar in the sense that the military institutions are the critical institutions for the democratic process.

Mr. OBEY. If I can interrupt, in the Philippines the signal we sent to the military was we were going to reduce their military aid until they got their act together.

Why should we be sending the opposite signal to Liberia?

Mr. SCHNEIDER. There are a number of differences in the situation. In the Philippines, we had a large U.S. military presence there associated with Subic and an extremely close relationship between many members of the Philippine military and ourselves. As a consequence, we were able to have a very substaintial amount of influence, and I think influence very much to the good.

Liberia is a different case. They don't have the same kind of tradition of democratic processes the Philippines had, and the development in some ways is more primitive than the Philippines.

We think with this military assistance—we may be wrong—but our judgment is with the military assistance that we will have the leverage with the Liberian military to try and move them in a democratic direction. I cited in my earlier response to a question raised by Mr. Porter that some of the developments that have taken place in the last month are good, some bad. We are working hard to try and improve the ratio of good to bad. But it will take some time, and I think we are on the right track.

### THE LAVI FIGHTER AIRCRAFT

Mr. OBEY. I have a number of questions on Pakistan, Iran, which I want you to respond to for the record. Let me ask you a question about the Lavi. The last time I was in Israel, I was surprised at the number of Israeli officials who privately would raise questions about the wisdom of pursuing the Lavi. I know it is very controversial. I know costs for the plane increased quite a bit, to put it mildly.

What are the levels of those increased costs? Can you tell us, for the record, exactly what has happened to those costs?

Mr. SCHNEIDER. There has been——

Mr. OBEY. Or the General, either one.

Mr. SCHNEIDER. There have been some reviews of the cost of the aircraft, and the divergences are narrowing, but I don't think we, as yet, have a definitive agreed-upon estimate of the cost. Perhaps General Gast can amplify.

General GAST. Sir, as you may have read in the press, the cost of Lavi has gone up higher than they estimated two or three years ago when the program began.

Mr. OBEY. By what?

General GAST. Perhaps as much as 30 or 40 percent. Particularly in the research and development portion of it. There have been some estimates made by our side which are even higher than the Israeli side. The Israelis are studying that material. They will be back to us to try to get a—hopefully what we are looking for is achieved, mutually agreeable cost estimate of the aircraft. That has not been achieved yet.

Mr. OBEY. Can you tell me, in light of those costs, does further development of that airplane make military sense? What support, in your judgment, exists within the Israeli Government for continuing the program? How much concern do people—have the Israeli leaders expressed to you about the doubts—should we continue to earmark funds for that purpose since the budget is going to get a lot tougher?

General GAST. The approach that has been taken by the administration, certainly within the Department of Defense, is that we first need to understand together what the projected cost is going to be of the aircraft. We have clearly indicated our concern about the priorities that the Israelis should undertake given whatever those costs are going to be. We assume we will not have increases in foreign aid or military assistance.

I think once they see that data, they will be the best to make that judgment, given the fact that military assistance is not likely to increase. as to whether they will want to stretch out the program, or whatever they want to do, I think that is going to be an internal matter for them to decide.

Mr. SCHNEIDER. One other matter, Mr. Chairman, with respect to the earmarking question. Congress agreed last year in the Appropriations Act to eliminate this Lavi-specific earmark so that the Lavi program could compete with other offshore procurement projects to facilitate an Israeli ability to bring the priorities into focus. I think that this process is underway, and it would be best left to the Israelis to make the judgment, because, as General Gast said, the resources are not likely to be substantially larger, and they have to weigh this mission against the need to perform other military missions.

## MOZAMBIQUE

Mr. **Obey**. My predecessor from Wisconsin, Mel Laird, has mentioned to me on more than one occasion his belief that it would be smart for this country to try to build a better relationship with Mozambique by providing assistance. The country is a Marxist regime; it has a treaty of friendship with the Soviet Union. Under the administration freedom-fighting doctrine, as it applies both to the Contras in Nicaragua and Mr. Savimbi and a few others, why should we be providing U.S. assistance to guerrillas in Mozambique rather than providing assistance to the government?

Mr. **Schneider**. The situation with respect to Mozambique is a complicated one. There have been some signals the regime might like to get out from under the current dominant influence of Soviet Bloc advisers and dependence upon Soviet Bloc resources, and the existence of some assistance resources provides an opportunity or provides the resources to be available if an opportunity arises that we could push the government out of its current linkage with the Soviet Bloc.

It is not clear that that opportunity will arise, but there have been some signals recorded by our officials who have been close to the scene. So it is like a number of other accounts in controversial areas, it provides the resources for an opportunity that we may be able to exploit.

## CONTRA AID

Mr. **Obey**. Let me ask either of you gentlemen, is there any additional information on the Contra aid request you want to provide? Are there additional points either you want to make in terms of the advisability of the Congress accepting the President's request for the $100 million aid package to the Contras?

Mr. **Schneider**. Just as I would say a footnote in support of it, Nicaragua is the central source of instability in the region. Or let's say the central source of which we don't have direct control. We have good cooperation with the Congress on an economic assistance program we think will help deal with the problem, but until we can find some technique to discourage the use of the military instrument in Nicaragua, we are not going to have much success. So I think the modest investment now in support of the proposal the President has made will avoid both the risk of greater U.S. military involvement in the future and contribute to the effective implementation of other forms of assistance Congress is providing elsewhere in Central America.

Mr. **Obey**. General.

General **Gast**. I cannot be more eloquent than Secretary Weinberger on this matter.

Mr. **Mrazek**. I think so, too.

General **Gast**. Aside from the impact of Nicaragua, from cultural, economic and other things, from a defense point of view, we certainly don't need another Cuba. Our contingency plans and ability to move are severely hampered by that. We do not wish to see that develop.

Mr. **Obey**. I won't argue with you, because I made my point clear to Secretary Shultz.

I have a number of other questions which I would like to put in the record, but I would make just one observation, in closing. I read Mr. Buchanan's intellectual thuggery that passed for analysis yesterday in the Washington Post, and I just have to say that when I read that piece, what I see is someone who has very—a much lower degree of confidence in the strength of America's image around the world than I do. When I see someone sweating overtime because of the tremendous progress that the Soviet Union is making in countries like Angola, Mozambique, Ethiopia, South Yemen and Cambodia, I just have to say that I regard those as Congressman George Brown said last night on the House floor, as the basketcases of the Third World.

I just think if you take a look at the record over the past 15 years under this administration and under other administrations, America has done pretty well in demonstrating to the world that our model is a hell of a lot more desirable than any model that the Soviets provide. And I want to—because the words were, I thought, so incredibly good, I would just like to read a couple of statements, and I would recommend you read it.

He says, "But Buchanan does not seem to be able to conceive that Communist doctrine is so flawed and so unable to project its ideologies, so weak that they can only make an impact where the U.S. renounces its own heritage to support suppression of freedom and democracy by home-grown autocrats spouting pseudo anticommunism."

And then he said "Communism would wither on the vine if the world could look again to America for leadership and support for authentic revolutions. I think events in the Philippines demonstrated that." He said, "We supported too long tyranny in Cuba, and we got Castro; we supported too long tyranny in Nicaragua, and we got Ortega." I, personally, believe if we had pulled the plug on Mr. Somoza a year-and-half earlier than we did, we would have had a pro-America, pro-business Western-oriented President of that country. In fact, if you take a look at Adolfo Colero, who is today one of the heads of the Contras, I personally believe he would have had a fair chance in being President of that country if we had pulled the plug on Somoza a year-and-a-half earlier, and that we didn't is a real tragedy in terms of defending what we believe in.

And what he said is "We supported too long tyranny in Nicaragua and got Ortega. In prior years, we supported too long the colonial tyranny in Portugal and Africa, and we got the Marxist Governments of Angola and Mozambique." Then he said this about Central America, and I am not sure I agree with all of it, but I think it is pretty good stuff. "Nicaragua is an utterly impoverished country of less than three million people surrounded by four other Central American countries with a combined population of 15 million, all except for Costa Rica, with substantial armies and a history of frequent wars among themselves and with Nicaragua. Their commitment to democracy and freedom is fragile, but improving. They are invulnerable to direct attack by Nicaragua since this would trigger armed response by the U.S. and other hemisphere allies under the Rio Treaty, but they are not invulnerable to internal revolution supported by the Sandinistas if they fail to sustain economic and social and political progress for their people."

In light of that, I would ask the question, why is the administration right, and why is the President of Costa Rica wrong when he tells us if we want to do something with that $100 million, we should give it to Honduras, Guatemala or Salvador to improve their own economic position? I am not suggesting for a moment we ought to take the pressure off the Nicaraguans, but I believe the best way to get pressure on the Nicaraguans, frankly, would be for us to get in the driver's seat on negotiation efforts.

I don't think Contadora ever goes anywhere unless the United States takes the lead in it and tries to turn it from generalized concepts into firm, specific proposals. And I also think that if we were to do that, while we were pulling the Contras back and perhaps providing them with retraining in order to make them a military operation worth anything, I would think that that kind of pressure, having the agreement rather than the disagreement of our regional allies, would be a far more effective way to change the behavior of the Sandinistas than $100 million, which, at best, is going to play to a tie. It certainly isn't enough to have any significant impact on the behavior of those birds, the Sandinistas, I mean, or it certainly isn't going to topple them.

Mr. **Schneider**. I don't think I can improve on the characterization Secretary Shultz made of the process he has undergone to try to stimulate negotiations of some sort with the regime. I think the prospects of doing some good in stimulating the Nicaraguans toward a process of negotiation could be undertaken, however, if the Congress would support this initiative.

It is not that the $100 million per se is going to solve the problem, but if the Congress indicates that it is prepared to go the distance as far as keeping the pressure up in every dimension until Nicaragua can be goaded into accepting a democratic orientation, that until they are persuaded of that, they are not going to back off, because they have the support of their totalitarian allies.

I am persuaded that the benefits that we have gotten by being able to maintain pressure on multiple fronts, whether it is in Nicaragua or in a different vein in other parts of the world, has served as well. Obviously, it is not an easy policy to explain, and for Members of Congress, it is often difficult to defend, but I think it is the right course, and I think it has proved successful.

We have been able to extend democratic regimes throughout the region in the past several years, not only due to this administration, but rather largely due to this Congress.

Mr. **Obey**. Could you supply the committee with a listing of the kinds of ammunition and equipment and other goods you would be providing to the Contras if you got that package?

Mr. **Schneider**. We will provide information on a classified basis.

[The information follows:]

Because of the sensitive nature of this proposal, this information has been provided solely to the Intelligence Committees of the Congress.

Mr. **Obey**. It is around other places, but I want to ask that question.

Mr. **Schneider**. Fine, we will provide it on a classified basis for you.

Mr. **Obey**. Thank you, gentlemen, very much——

Mr. **Mrazek**. Mr. Chairman.

Mr. **Obey**. Sure.

Mr. **Mrazek**. Yes. I would very much appreciate if we could arrange for a meeting to discuss, on a classified basis, some of the information that Secretary Shultz tangentially spoke about in regard to Pakistan and its involvement in the nuclear program.

Mr. **Schneider**. We will arrange for a briefing for you.

Mr. **Mrazek**. I would appreciate that very much.

Mr. **Schneider**. Thank you.

Mr. **Obey**. One other question which I wanted to ask. Don't answer it here, but I would like the information. In light of your response to Mr. Porter on Japanese assistance, can you give us some idea what the Japanese have done in terms of changes to their aid program since 1981 or 1980 vis-a-vis today in Thailand, Korea, Pakistan, those countries?

Mr. **Schneider**. We will do it, Mr. Chairman.

[The information follows:]

In the countries noted by Mr. Obey—Thailand, Korea, Pakistan—Japan's foreign assistance role has been consistently substantial throughout the 1980's. Japan is the leading donor of foreign assistance to Thailand, with average annual disbursements of $211 million in development assistance from 1980–84. Japan agreed to a 10 year, $4 billion aid program for Korea in 1983. In Pakistan, Japan is the second largest donor of aid, having disbursed development assistance averaging $93 million annually from 1980–84.

It should also be noted that over the last ten years Japan has embarked on the most ambitious expansion of overseas development assistance (ODA) programs among the industrialized nations. Japanese overseas development assistance (ODA) now ranks second in the world after that of the U.S. In 1984 the Japanese disbursed $4.3 billion in ODA. Japanese annual ODA spending doubled between 1977–1981 and another doubling target set for 1981–1985 was substantially achieved. In a new aid-doubled plan announced in September 1985, Japan will aim to double annual levels for the third time to reach an annual budget of over $8 billion by 1992. In the 1986–1992 period, Japan expects to spend a total of over $40 billion in foreign aid.

Mr. **Obey**. Thank you very much.

## Questions Submitted by Mr. Obey

### The Reagan Doctrine

*Question*. Mr. Schneider, is there an administration doctrine on freedom fighters? If so, is the policy aimed at overthrowing Marxist regimes or at pressuring them to enter into negotiated settlements with their opponents?

Answer. The administration's position on aiding freedom fighters is not aimed at either of these alternatives. Rather, it is aimed at giving effective aid to those who have taken the initiative to resist Marxist-Leninst dictatorships so they can struggle for the freedoms that Communist rule denies them. In our view, such aid is justified both morally and strategically. It is morally justified because of the human rights abuses that are an integral part of Communist dictatorships. And it is strategically justified because of the threat these regimes pose to our own security and to the security of our allies and friends.

Aid to resistance forces does not undermine our commitment to negotiated settlements. On the contrary, strong resistance movements can only increase the likelihood of bringing Communist rulers to the bargaining table. As Secretary Shultz has frequently observed, power and diplomacy must go hand in hand. The Nicaraguan Communists, for example, have so far refused to consider a negotiated regional settlement because they believe that their military power will allow them to consolidate their regime. We want to convince them that a military approach to stabilizing that dictatorship does not exist. By strengthening the Nicaraguan resistance, we are giving the Communist regime an incentive to come to the bargaining table. Thus, strengthening freedom fighters does not contravene our search for negotiated settlements; on the contrary, it can be the precondition for negotiation itself.

*Question.* In President Reagan's address to the United Nations last October he stressed the U.S. commitment to achieving regional peace settlements in troubled regions. How does this speech square with the Administration's request for covert military and overt economic aid to guerrillas in Nicaragua and covert assistance to the Angolan rebels?

Answer. The President's initiative on regional conflicts at the United Nations in October was and is intended to enhance the incentives for peaceful political solutions among the warring parties in troubled regions, thereby supporting regional and other international peace-making efforts. As the President noted in his recent report to Congress on *Freedom, Regional Security and Global Peace,* "in all these regions, the Soviet Union and its clients would of course prefer victory to compromise. That is why in Afghanistan, in Southeast Asia, in southern Africa, and in Central America, diplomatic hopes depend on whether the Soviets see that victory is excluded. In each case, resistance forces fighting against Communist tyranny deserve our support."

A review of events in Nicaragua shows that the communists will not negotiate except under military pressure. In their 1984 Good Friday Pastoral Letter, the nation's bishop's called for as dialogue with the democratic resistance. The regime refused. In its San Jose Declaration of March 1985, the resistance called for Church-mediated negotiations and a cease fire. Again, the regime refused.

The regime has also spurned our efforts to find a peaceful settlement. In 1981, before there were any "contras," and in 1982, we offered to restore the aid we gave from 1979 till 1981 (more than from any other country), if the regime would reverse its hostile policies toward its neighbors. In 1984, we held nine rounds of direct talks with the regime, but it refused to consider serious proposals to halt subversion and open a dialogue with its opponents. Last October, we offered to resume bilateral talks if the regime accepted the March 1985 San Jose Declaration. It refused. Nevertheless, the United States maintains a standing offer to talk any time the Nicaraguan communists express willingness to discuss changes in their policies on four principal concerns: Soviet/Cuban presence; their massive military buildup; support for subversion of their neighbors; and internal reconciliation. On February 10, 1986, I told eight contadora foreign ministers that if Nicaragua moved on these matters, we would enter talks with the regime, provided it also talked with the resistance.

The United States has strongly supported the Contadora peace efforts from the start. The problem basically has been the Nicaraguan communists' position that we should halt our support for the resistance and end military maneuvers, and in return, they would discuss the Contadora principles, such as internal reconciliation, at some undefined future time. In short, they have insisted on a separate accommodation with us prior to a Contadora agreement; this ploy is unacceptable. Consistent with its attempt to sabotage the Contadora process, in June 1985 Nicaragua aborted a meeting of Contadora plenipotentiaries, leading to a four-month hiatus in the Contadora negotiations. In September 1985, the Contadora Group tabled a third draft of an agreement. On November 11, Nicaragua rejected this draft, essentially insisting on a separate agreement with the United States that would meet its concerns and leave it a free hand to crush the resistance. On December 3, Nicaragua submitted a formal request for suspension of Contadora until May 1986. At a meeting of the OAS on December 11, only Nicaragua opposed a resolution urging continuation of Contadora and Central American representatives in Panama.

Rather than negotiate, the communists have pursued a military solution from the start. Since 1981, the Soviets have supplied at least $500 million in weapons to Nicaragua. Today there are around 50 Soviet military advisers in the country, and about 3,500 Cuban military and security personnel, some serving in combat. The regime's public posture on negotiations has been a ploy to manipulate and deceive U.S. opinion.

The record on negotiations demonstrates that only through military pressure can the Nicaraguan communists be brought to the negotiating table. Thus far, the biggest obstacle to negotiations, apart from the communists' intransigence, has been our own failure to provide military assistance to the democratic resistance.

With respect to Angola, again, the evidence is clear that the MPLA regime, backed by the Soviets, has been pursuing a military solution. Since 1979, the Soviets have provided the regime $4 billion in military assistance, $2 billion over roughly the last two years. We believe a peaceful settlement has to include UNITA, and we believe it should receive appropriate and effective U.S. aid, consistent with our policy for the region.

*Question.* In assisting the UNITA guerrillas in Angola, are we seeking the overthrow of the Angolan regime? The Assistant Secretary of State for Africa, Chester, Crocker, has said that our goal is to foster a negotiated resolution of southern Africa's conflicts. Will Angola respond to our mediation efforts if we are aiding an internal guerrilla movement?

Answer. It is not our aim to overthrow the MPLA regime. Our policy for Angola/Namibia is based on the understanding that military solutions are not viable. A negotiated settlement on the independence of Namibia under UNSCR 435 and the withdrawal of Cuban troops from Angola is the only way to attain the durable peace and stability necessary to deny the Soviets the opportunity to exercise influence in the region. The withdrawal of foreign forces from Angola and Namibia will help the Angolans work out a solution to their internal problems themselves.

If the MPLA wants the South Africans out of Namibia, and therefore no longer in a position to launch the kinds of assaults into Angola which we have seen in the past, it will have to agree to Cuban troop withdrawal. If it chooses instead to continue to try to solve its domestic problems by military means, it may cite reports of U.S. assistance to UNITA as an excuse for retaining Cuban troops. But the real issue is not whether or not there is U.S. assistance to UNITA. Rather, it is whether the political will exists in Luanda to seek a negotiated regional settlement.

*Question.* The Administration is requesting $15 million in FY 1987 for Economic Support Funds assistance for Mozambique. This country has a Marxist regime that has entered into a treaty of friendship and cooperation with the Soviet Union.

Under the Administration's Freedom fighting doctrine shouldn't U.S. assistance to Mozambique be going to the anti-Marxist guerrillas?

Answer. The intent of our assistance to Freedom fighters is to stop the spread of Communism. What we see in Mozambique today is a government that, having seen Communism fail to develop a health economy, is backing away from the Soviet model and moving toward non-alignment supported by adoption of a mixed economy. Our assistance to Mozambique is designed to encourage and abet this favorable development. Supporting the insurgents in this context would be counterproductive, since this would constitute U.S. rejection of Mozambique's move toward the West, force the government into heavier reliance on Soviet military assistance, and result in greater Soviet influence over the country's domestic and foreign politics.

*Question.* The FY 1987 request includes $15 million for freedom fighters in Afghanistan and $5 million for assistance to fighters associated with Cambodia.

Do you believe this level of funding is going to be sufficient to move to the overthrow of either Afghanistan or Cambodia? Are we entering into an expensive program of freedom fighter support that may have little pay-off except for face value?

Answer. The purpose of our assistance to the Cambodian non-communist resistance is to provide a tangible U.S. response to the Association of Southeast Asian Nations (ASEAN), which has requested international support for the Cambodian people's efforts to rid themselves of foreign occupation. The ASEAN effort is aimed at preventing Vietnam's consolidation of its rule in Cambodia and at building up the non-communists as a viable alternative to both the Vietnamese and the Khmer Rouge.

Our funding of the non-communists is supplemental to, and only a fraction of, what other countries are doing. It is limited to non-lethal aid (weapons are provided by others).

The goal of the assistance from the U.S. and others is essentially political, not military. We want to add to the incentives for Vietnam to come to the bargaining table and negotiate a peaceful settlement in Cambodia. These incentives include not only military pressure, but other forms of pressure as well, such as our policy of diplomatic isolation and economic embargo.

We do not expect the small amount of U.S. aid in itself to lead to the overthrow of the Vietnamese puppet government in Phnom Penh. We do believe that, combined with other elements of a comprehensive, internationally-supported policy, it will be a step in the direction of restoring Cambodia to the Cambodian people.

Our request for the Afghan resistance will provide humanitarian assistance to war-affected Afghans inside Afghanistan. Its purpose is to counteract the Soviet attempt to eliminate the resistance movement's base of support in the Afghan countryside by enabling the Afghan resistance to provide more medical services and education programs inside their own country. The program helps ease the burdens of war borne by the Afghan people; it helps them carry on the struggle against Soviet expansionism and it demonstrates US support for the Afghan cause. It also strengthens our effort to sustain the maximum pressure on the Soviets to negotiate a comprehensive and balanced political settlement encompassing the prompt withdrawal of their occupation troops.

*Question.* What do you estimate the costs per year for the U.S. providing support to "freedom fighters" in Afghanistan, Cambodia, Angola and Nicaragua? How do you plan to pay for this program?

Answer. In FY 1986 the Administration introduced two new foreign assistance programs: one providing non-lethal supplies to the non-communist Cambodian resistance, and the other providing humanitarian assistance to victims of the fighting in Afghanistan. In FY 1987 we are asking for $5 million and $15 million respectively for these two programs as part of our normal foreign assistance request.

In FY 1985 the Administration requested and the Congress approved a $27 million package of non-military assistance to the Nicaraguan Contras. As you well know, the Administration is currently requesting Congressional approval to provide a further $100 million, to include both military and non-military assistance. At present we are not providing any assistance for UNITA in Angola.

## PAKISTAN

The Administration has requested an increase in security assistance for Pakistan:

| | 1986 | 1987 | Increase | |
|---|---|---|---|---|
| | | | Amount | Percent |
| ESF | 239.3 | 250 | 10.7 | 5 |
| FMS | 311.0 | 340 | 29.0 | 9 |
| Total | 550.3 | 590 | 39.7 | 7 |

This has been part of a 5-year program to expand Security Assistance to Pakistan. It is my understanding that the Government of Pakistan has been seeking a large increase in assistance over the next five years, and that discussions are now taking place.

In light of the current budget situation, what kinds of commitments are you making to Pakistan?

As you know, FY 87 is the last year of our current multi-year program of economic and military assistance. We are committed to a new multi-year program beginning in FY 88, and during the last six months we have had discussions with the GOP on both program levels and content. Since such discussions are ongoing, it is premature to comment on what a new package will look like.

Pakistan is a front-line state, facing Soviet aggression across its border with Afghanistan. Cross border attacks resulted in several hundred casualties in Pakistan in 1985 alone, and Soviet pressure on the Pakistan government to abandon its principled stand against the continued Soviet occupation of Afghanistan has increased. The new civilian government in Pakistan has assessed its needs and requested our undiminished support in the face of these pressures. We have made it clear to Pakistan's leadership that we will be as responsive as our own severe budget constraints permit to meeting Pakistan's requirements during the post FY 87 period.

What about explaining the budget situation to other countries that are seeking assistance. Are we giving them the word to not be optimistic about future programs?

In explaining the FY 1986 Foreign Assistance allocations to recipient countries we have explained the effects of our budget problems on the foreign aid program. While stressing our commitments to our friends and allies we have attempted to give them a realistic view of our own situation and prospects.

*Question.* The FY 1987 request includes $5 million in FMS for Gabon, of which the funds are primarily for a mobile reaction force. In the past, the French Government has provided such forces at the request of the respective African government. This type of new request ties into my question about whether the Administration is really serious concerning budget restraint. Why is the U.S. government becoming involved in an area that it has long regarded as being a French responsibility? Has this involvement been requested by the French and Gabonese governments? Does the Gabonese government view this proposal as just an arms sale or as including a commitment to provide military forces on request as the French have done?

Answer. The United States has a number of military and economic assistance programs with Francophone countries in Africa. In these cases, we acknowledge that France is the pre-eminent foreign power and has treaty and moral commitments to come to their defense. Nevertheless, the US has bilateral interests in many of these countries, including Gabon. We also have an interest in demonstrating support for these moderate, pro-Western states. The type of assistance we are requesting for Gabon is FMS treasury rate credit. Gabon is in the process of upgrading and modernizing its armed forces and does not want to be dependent on just one supplier

(France). It wants to have a relationship—including a military one—with the United States. We consult regularly with the French on US involvement with Francophone nations and the French welcome our participation, including in the military area. The US provision of FMS credits and subsequent sales of military equipment does not imply a commitment by the US to provide military forces to Gabon. This is fully understood by the Gabonese and the French.

## COUNTRIES IN ARREARS

*Question.* Last year you provided the Committee with a listing of countries that were in arrears on FMS loans. This listing indicated that as of last year more than $1 billion in loan payments were outstanding to the U.S. Government.

Under the Brooke Amendment have you in fact withheld aid from any countries that are in arrears? Do you plan to take any such action in the future?

Answer. As of February 28, 1986, total FMS loan arrearages on guaranteed, direct, and rescheduled credits totaled $604.7 million. A DSAA listing of FMS loan arrearages as of September 30, 1985, is being provided separately for reference. It should be noted that some of these arrearages are temporary and are due to technical difficulties in the international wiring of financial transfers.

The Administration is fully aware of its obligation to enforce U.S. law and has complied with the provisions of the Brooke-Alexander Amendment by withholding assistance from any country which is in default for more than one year in payment to the United States of prinicpal or interest on any loan made pursuant to the Foreign Assistance Act and the Arms Export Control Act.

A relatively small number of countries have fallen under Brooke Amendment sanctions over the past year. Some have remained under Brooke Amendment sanctions for a considerable period, while others have resolved the situation by making Brooke-sensitive payments or by rescheduling their foreign debt through the multilateral Paris Club.

The administration will continue to monitor loan repayments carefully in order to comply with legislative requirements and prevent program disruptions.

*Question.* It appears that a number of countries on last year's list of arrears are receiving increases in FY 1987 FMS funding:

| *Country* | *Increase (millions)* |
|---|---|
| Turkey | $115 |
| Oman | 21 |
| Jordan | 34 |
| Cameroon | 7 |

If countries are in arrears on FMS repayments, why are you requesting increases in accounts?

Answer. FMS credits are proposed only for those countries that are considered financially capable of repaying such loans. Relative to our FY 1986 request, our FY 1987 FMS funding request includes increases for two of the aforementioned countries, Turkey and Jordan. The projected changes in FMS financing are as follows:

### FOREIGN MILITARY SALES FINANCING

[In millions of dollars; fiscal years]

| | 1986 request | 1987 request | Difference |
|---|---|---|---|
| Turkey | 555.0 | 600.0 | +45.0 |
| Oman | 58.3 | 40.0 | −18.3 |
| Jordan | 95.0 | 115.0 | +20.0 |
| Cameroon | 7.0 | 7.0 | 0.0 |

By and large, recipients of FMS credits make every effort to meet their financial obligations on time. For a variety of reasons, however, repayments by a number of countries become overdue. Very few of these countries actually fall under Brooke Amendment sanctions. Over the past year, neither Turkey, Oman, Jordan, nor Cameroon has fallen under Brooke Amendment sanctions. The U.S. Government monitors loan arrearages very closely in order to comply with U.S. law and prevent program disruptions.

Increases in FY 1987 FMS are being requested in some cases to facilitate the operation and maintenance of U.S.-origin equipment. Such assistance is also required for certain friends and allies who must meet progress payments on equipment previously purchased from the United States.

### UNCOMMITTED FMS AND MAP FUNDS

*Question.* According to information we have received from the Defense Security Assistance Agency (attached), more than $2.5 billion in FMS and MAP funds from previous years have yet to be committed. Why can't you use these uncommitted funds to provide for FY 1987 MAP and FMS programs?

Answer. According to the financial records of the Defense Security Assistance Agency, the uncommitted loan and MAP balances as of 26 Feb 86 covering FY 1985 and prior year funds total $2.33 billion. Of the $2.33 billion uncommitted balances, $2.24 billion ($1.27 billion for Greece alone) apply to the 15 countries identified in the table below, and $1.28 billion of this balance relates to FMS credits made available during FY 1985.

The balances of uncommitted funds shown are highly transitory. Countries have firm plans for use of the funds. Examples are discussed below. In almost all cases we have in hand letters of request, or letters of request or commercial contracts are in preparation. The funds are not "excess."

How will these funds be used? *Indonesia* intends to commit all of its FMS credits to the F-16 program which recently has been reported to the Congress. *Jordan* has earmarked a substantial portion of its FY 85 and prior credits for payments due on cash cases, including purchases of AN-TPQ 36/37 radars, the PIP II upgrade of HAWK missile systems, and ammunition. *Portugal's* uncommitted funds will be used primarily to purchase upgraded P3 aircraft, frigates, and Chaparral air defense weapons. *Spain's* uncommitted credits will be applied primarily to four major programs: F-18, AV-8B, LAMPS, and FFG equipment, for which payments due extend through 1993. The Spanish have typically applied the bulk of their annual credits toward these programs. *Thailand* is expected to apply virtually all of its uncommitted funds toward the recently implemented air defense system FMS case. *Greece* has been saving its FMS credits to finance a major F-16 aircraft purchase.

UNCOMMITTED FUNDS

[Dollars in millions]

| Country | Total | Uncommitted against FY 1985 loans |
|---|---|---|
| Indonesia | $37.7 | $32.5 |
| Jordan | 78.3 | 75.6 |
| Kenya | 12.7 | |
| Korea | 88.6 | 88.5 |
| Lebanon | 11.7 | |
| Malaysia | 23.1 | 4.0 |
| Oman | 84.2 | 40.0 |
| Peru | 11.1 | 8.0 |
| Philippines | 27.0 | 10.0 |
| Portugal | 62.9 | 48.8 |
| Spain | 407.3 | 400.0 |
| Thailand | 75.5 | 71.3 |
| Tunisia | 27.7 | 5.9 |
| Yemen | 18.1 | |
| Subtotal | 966.0 | 784.6 |
| Greece | 1,270.7 | 500.0 |
| Total | 2,236.7 | 1,284.6 |

Note: Figures may not add due to rounding.

The amount of future FMS credits or MAP needed for a particular country take into account many more factors other than the uncommitted balances at a particular point in time. The circumstances by when each country plans to utilize "uncommitted" funds are different. Some countries earmark particular loans for specific future procurement programs leaving the loans "uncommitted." Other countries specify cash as method of financing on particular FMS cases and then request that FMS credit funds be substituted when the actual funds must be disbursed.

Security Assistance funds are not officially recorded as "committed" in DSAA records until FMS Letters of Offer (LOAs) are issued to countries, or commercial contracts are approved for credit financing, or countries officially notify DSAA of the desire to apply the funds to LOAs originally signed under cash terms of sale. In the first two instances, the process of LOA preparation/commercial contract negotiation generally does not start until credit agreements are signed and the country knows how much money it has to work with. In the latter instance, countries usually do not request revision to terms of sale until billings are received and disbursements must be made.

*Question.* FMS and MAP funds are provided on a one-year availability for obligation, how do you account for such a large carryover in uncommitted funds? Are the funds being committed in accordance with the justifications provided to the Congress?

Answer. It is true that FMS direct credit and MAP funds appropriated during a particular fiscal year must be obligated by 30 September of that fiscal year or else be lost for further use. FMS credit funds allocated to a particular country are obligated on the basis of the signed loan agreement; MAP funds are obligated when, under section 503(a)(3), FAA, procedures, the funds are transferred to the country's FMS Trust Fund. The FMS credit funds thus obligated are committed to specific FMS cases (LOAs) or to individual direct commercial contracts with U.S. industry approved for credit financing by the Defense Security Assistance Agency. Previously obligated MAP funds are applied to specific FMS cases in the same manner as are credit funds. MAP funds cannot be used to finance direct commercial contracts. To summarize, the fiscal process is to obligate available FMS credits and MAP funds in bulk, then to commit these obligated funds to specific FMS cases or approved direct commercial contracts as the agreements on each case are made. Under this process, at any point in time, it is possible and even probable that some of the obligated FMS credit or MAP funds will remain apparently "uncommitted." This is particularly true for those FMS credits or MAP funds which have recently been made available.

All funds are committed in accordance with the justifications provided to the Congress.

## UNOBLIGATED FMS AND MAP FUNDS

*Question.* The country listing provided by DSAA shows only uncommitted balances. What are the balances for countries where there is a commitment for funds but the funds remain unobligated? Could those unobligated funds be used as a source of funding for FY 1987.

Answer. The country listing provided by DSAA, contrary to the above question, showed the following information:

FMS Credits (by loan agreement): Obligated; Committed (Commercial Contract FMS Case); Uncommitted.

MAP (by apportioned amount): Obligated: Committed (FMS cases only); Uncommitted.

There are no unobligated funds not shown on the country listing other than those FY 1986 FMS credits and MAP funds not yet apportioned by OMB.

## UNCOMMITTED FMS AND MAP FUNDS

*Question.* It appears that the large unobligated and uncommitted balances relate to fairly poor program planning. Are you taking steps to provide more specific and concrete program planning?

Answer. First, there are no large unobligated balances concerning FY 1985 and prior years FMS credit and MAP funds. Second, the uncommitted balance is not excessive when all factors (e.g., portions attributable to FY 1985 FMS credits, plans of individual countries such as Greece, Spain, Thailand, Jordan, and Portugal, etc.) are considered. Country program planning can be improved. As explained in pages 18–21 of Volume I of the FY Congressional Presentation for Security Assistance Programs, the Executive Branch devotes a great deal of effort to achieve closer planning with our security assistance partners. Although there are different planning fora and a range of differing national capabilities to plan and execute those plans, we are making much progress in heightening countries' awareness of long lead times, the need for a total package (hardware plus support) approach, and an awareness of the level of cost and the future debt implications of major arms acquisitions. There are, however, two major obstacles to planning with countries:

Our inability to guarantee upcoming year and out-year funding levels.

Inadequacy of current funding levels to cover extensive military needs in many countries.

Given this level of uncertainty it is not unreasonable for countries to change their minds once funds become available as to what defense gaps they can afford to attempt to close.

In sum, the uncommitted balances do not reflect poor program planning at all. Rather, they represent prudent planning and the careful process of concluding cases for use of funds.

## COMMITTED AND UNCOMMITTED FMS AND MAP FUNDS

*Question.* Place in the record at this point an up to date table on both uncommitted and committed unobligated funds.

Answer. As indicated in the answer to a previous question, FMS credit and MAP funds are obligated before the funds are committed to specific FMS cases or direct commercial contracts with U.S. industry. There are no "committed unobligated funds." The table below provides a country by country status of committed and uncommitted funds, to include FY 1986 funds available as of 26 February 1986.

It should be recognized that the balances shown in each of the columns are transitory. The countries have firm plans for the use of these funds. In almost all cases there are either letters of request or those letters are in preparation, or commercial contracts are in preparation. For instance, in the case of Chad, there are firm plans for use of all the "uncommitted" funds plus an additional $10 million worth of materiel and services to be provided under a Sec. 506(a) action.

### STATUS OF FMS CREDIT/MAP FUNDS AS OF 26 FEBRUARY 1986

[Dollars in thousands]

| Country | Committed | Uncommitted |
|---|---|---|
| Antigua | $2,108 | $120 |
| Barbados | 332 | 128 |
| Botswana | 18,814 | 5,186 |
| Belize | 991 | 9 |
| Bolivia | 8,667 | 1,333 |
| Sri Lanka | — | 2,000 |
| Chad | 6,966 | 5,666 |
| Cameroon | 14,508 | 4,892 |
| Colombia | 70,564 | 1,436 |
| Costa Rica | 32,465 | 1,035 |
| Zaire | 123,941 | 3,159 |
| Djibouti | 4,586 | 1,389 |
| Dominica | 1,845 | 8 |
| Dominican Republic | 29,336 | 2,514 |
| Ecuador | 48,415 | 4,085 |
| El Salvador | 505,260 | 15,440 |
| Ethiopia | 9,231 | — |
| Fiji | 298 | 2 |
| Gabon | 6,537 | 2,663 |
| Grenada | 6,270 | 135 |
| Guinea | 3,858 | 642 |
| Greece | 1,098,865 | 1,270,735 |
| Haiti | 1,715 | 284 |
| Honduras | 252,237 | 10,493 |
| Indonesia | 259,898 | 37,702 |
| Ivory Coast | — | 1,000 |
| Jamaica | 17,064 | 1,583 |
| Jordan | 650,741 | 78,259 |
| Kenya | 187,771 | 12,729 |
| Korea | 1,512,928 | 88,572 |
| Lebanon | 197,780 | 11,720 |
| Liberia | 55,121 | 49 |
| Madagascar | 868 | 1,182 |
| Malaysia | 29,375 | 23,125 |
| Malawi | 73 | 1,427 |
| Morocco | 426,648 | 11,502 |
| Oman | 105,783 | 84,217 |

## STATUS OF FMS CREDIT/MAP FUNDS AS OF 26 FEBRUARY 1986—Continued

[Dollars in thousands]

| Country | Committed | Uncommitted |
|---|---|---|
| Niger | 13,480 | 1,020 |
| Nicaragua | 3,000 | — |
| Peru | 35,401 | 11,094 |
| Philippine Islands | 272,701 | 47,299 |
| Pakistan | 880,777 | 4,223 |
| Panama | 35,154 | 846 |
| Portugal | 280,575 | 82,925 |
| Rwanda | 1,378 | 122 |
| St. Christopher | 2,598 | 64 |
| Senegal | 12,831 | 1,619 |
| Sierre Leone | 542 | 208 |
| Somalia | 148,244 | 16,756 |
| Spain | 1,517,721 | 407,279 |
| St. Lucia | 1,769 | 84 |
| Sudan | 289,258 | 10,742 |
| Thailand | 452,028 | 75,483 |
| Togo | 52 | 248 |
| Tunisia | 443,001 | 43,749 |
| Taiwan | 23,500 | — |
| St. Vincent | 1,478 | 165 |
| Yemen | 6,909 | 20,005 |
| Subtotal | 10,114,256 | 2,410,352 |
| Egypt | 8,781,958 | −1,966,958 |
| Israel | 18,302,301 | 1,852,963 |
| Turkey | 2,944,998 | −189,098 |
| Total | 40,143,513 | 2,107,259 |

### FMS GUARANTY RESERVE FUND (GRF)

Since the late 1970s, poor economic conditions in the Third World and high interest rates have made it difficult or impossible for several countries to make their FMS payments on schedule. Late payments and rescheduled payments have caused the GFR to be drawn down to $272 million at the end of fiscal year 1985. DSAA submitted a report to Congress in November 1985 (in accordance with section 106 of P.L. 99-83), with an admittedly optimistic forecast that the fund balance would be about $141 million at the end of fiscal year 1986 and about $105 million at the end of fiscal year 1987. GAO issued a report in October 1985 (NSIAD-86-10), that said DSAA projected a zero balance in the GRF by fiscal year 1987. GAO estimated that if Egypt continues to default and other countries also default, the GRF could be depleted in fiscal year 1986. DSAA suggested in its report five options for replenishing the GRF but did not evaluate them or recommend one of the options.

*Question.* On what basis does DSAA project that the FMS Guarantee Reserve Fund balance will be $140 million at the end of FY 1986 and still above the $100 million level at the end of FY 1987?

Answer. DSAA's report noted that "projecting the future cash position for the Guarantee Reserve Fund is a complex process".

Assumptions were made with respect to disbursements from the fund, recoveries into the fund, and reschedulings. The assumptions made focused on the five or six key countries that are the largest debtors guaranteed by the GRF. Presently those countries include Israel, Egypt, Turkey, Jordan, Morocco and Sudan. Given the wide range of economic and political factors that could affect the assumptions and the tendency of those factors to fluctuate over the short term, DSAA did not attempt to make assumptions that extended beyond the next two fiscal years. (Additionally there may be other countries that have historically met their FMS debt service obligations but may encounter currently unforeseen financial problems in the future.)

The assumptions DSAA made as a basis for the projections that will follow are:

(1) *Israel* has maintained its excellent payment record and will continue that record.

(2) *Turkey* will continue to pay both regular and rescheduled payments on time for the next two years.

(3) *Egypt* will continue to make each regular payment up to one year late but will not reschedule or fall subject to Brooke Amendment sanctions through FY 1987.

(4) *Jordan* will not reschedule and will make sufficient regular payments in time to avoid Brooke Amendment sanctions. *Sudan* will face similar considerations.

(5) *Morocco* will reschedule most of the payment that will fall due in FY 1986 and FY 1987 and will repay only the amounts due from previously rescheduled loans.

Based upon these assumptions and the fact that the Guarantee Reserve Fund cash balance stood at $271.7 million at the end of FY 1985, and that disbursements from the fund would probably exceed collections by approximately $130 million, the fund balance at the end of FY 1986 was estimated to be about $141 million. The study estimates that net disbursements from the fund will be approximately $36 million with an end-FY 1987 balance of $105 million.

*Question.* Although the GAO has predicted that the fund may be depleted during Fiscal Years 1986 and 1987, you have requested no new appropriations for the fund. When do you expect the GRF to be depleted?

Answer. We concur with DSAA's estimated as to when the fund may be depleted, noting that many factors may accelerate or delay GRF depletion. We have not requested a definite level of funding for GRF replenishment simply because that type of budgetary request has not been well received by the Congress. In addition, it is merely a "band-aid" approach to a longer term problem. Instead we intend to propose a permanent indefinite appropriation—as currently exists for some other Federal programs—which would automatically maintain the fiscal integrity of the Fund.

*Question.* What effects will the fall in oil possibly have on use of the fund?

Answer. Most recipients of security assistance are net oil importers who stand to benefit economically from the oil price decline.

Among the nations reviewed by the DSAA (GRF) study, Egypt is the only major "loser". Lower oil revenues and reductions in worker remittances will make it increasingly difficult for Egypt to meet its foreign debt obligations—including GRF repayments.

## NEED FOR MORE SPECIFIC PROGRAM INFORMATION

*Question.* Last year the Appropriations Committees directed that the Department provide more specific program and project justifications for military assistance projects. Although this year's request is a step forward, it is still impossible to find out from the project justifications specifically what military equipment and programs are going to be carried to Congress assistance.

When you come forward to Congress with FMS and MAP requests, do you in fact have specific program criteria locked into place?

If not, won't requirements by Congress to provide more specifics help you in obtaiing better planning from the countries involved?

How far can you go next year in giving us a detailed project and program detail for MAP and FMS projects? In other words, is the minor step taken this year part of a process to improve the entire justification process?

Answer. The FY 1987 Congressional Presentation Document (CPD) represents a complete revamping of previous CPDs. For the first time, country justifications link U.S. national policy interests, security assistance objectives for the country, and the ways the proposed programs serve these objectives and interests. Country programs, as portrayed in the "pie charts" on each country page, accurately reflect projected use of requested by mission and functional areas as known at the time of compilation of the CPD. Thus, the program criteria shown in the new CPD represent firm projections of program activity to utilize funds that may be provided.

Within the limits of country page formats and classification criteria, refinement of the presentation of program details will continue to be made, especially where circumstances permit even more detailed planning with additional countries. However, given format limitations and problems of classification, it is not possibie to put all program detail in the CPD.

We have made significant progress during the past five years in convincing countries to do more forward planning with the U.S. Defense Department. In that regard a significant number of countries have developed three to five year procurement plans with us. One of the strongest arguments for getting countries to plan with us is justification to Congress. Consequently, we do not believe a requirement for further detail in the CPD is itself a motivation. Assured financing at or near proposed financing levels is a prime motivator. In fact, the reduction in appropriations for FY 1986, leading to substantial reductions in military assistance for some countries, resulted in countries questioning the value of planning and providing requirements.

At the present time, planning is greatly complicated by (1) unpredictable U.S. funding, including the unavailability of clear funding prospects at the beginning of the fiscal year on October 1, which in turn (2) complicates the process of allocation and apportionment within the Executive Branch following final appropriations action (usually in a Continuing Resolution), and (3) the consequent requirements for replanning by the country (at this point more than a year after the time the original program was laid out for presentation in the CPD) due to changed military needs and changed costs and availabilities of equipment. At that point, Letters of Offer and Acceptance (LOAs) for cases utilizing funds will be negotiated, leading to further changes in detail.

For those countries where annual or multi-year funding is relatively assured, the accuracy of program detail is generally much higher than for those where it is not assured, since awaiting each step above to be completed before proceeding to plan cases is less necessary.

The Administration does wish to provide Congress with more information. As we informed the committees immediately prior to the publication of the FY 1987 CPD, we plan to make further improvements. We are also considering a classified addendum. A preferred procedure would be for the Administration to brief the committees on individual programs on a classified basis. We believe this procedure would be more satisfactory to Congress and also improve the quality of the justification and of the dialogue between the Administration and Congress.

### REQUEST FOR $50 MILLION FY 1986 CONTINGENCY FUND

Mr. OBEY. Mr. Schneider, as I noted in my opening statement to Secretary Shultz, you have requested a $50 million 1986 supplemental for a contingency fund.

What is this money for?

What legislative controls over it are you proposing?

Mr. SCHNEIDER. The President's budget identified an FY 1986 supplemental for "Foreign Assistance Contingencies;" however, the budget request noted that the fund was "proposed for later transmittal under proposed legislation." At this time, we have not yet finalized this request. Until we have done so, we cannot provide details or justification.

## Questions Submitted by Mr. McHugh

### STATEMENT OF THE UNDER SECRETARY

*Question.* In his prepared statement Under Secretary Schneider stated: "By definition, Security Assistance benefits other countries." Can you conceive of any circumstance in which security aid would damage rather than benefit other countries?

Answer. We could conceive of a series of circumstances wherein a country took on more security assistance debt than it could manage. Concern over adverse economic consequences would not remove—or necessarily outweigh—the military requirement which convinced the country it had to incur the debt in the first place. We carefully monitor the financial conditions of FMS debtors. It is precisely for this reason that we have asked the Congress for increasing levels of concessionality and grant assistance over the past few years.

*Question.* I am attaching four tables that I inserted into the hearing record this morning. Could you update these tables through September 30, 1985?

Answer. Updated tables are attached.

FROM: Military Loans: Repayment Problems Mount
As Debt Increases (GAO Report to the Hon.
David Boren dated October 1985)

**Table 2.1: Outstanding Debt for Major Debtor Countries** (Principal and interest)

Dollars in millions

| Country | Debt outstanding<br>Guaranteed | Total |
|---|---|---|
| Israel | $24,521 | $25,529 |
| Egypt | 14,337 | 14,337 |
| Turkey | 5,724 | 6,323 |
| Greece | 4,743 | 4,743 |
| Spain | 2,043 | 2,043 |
| Korea (Seoul) | 1,678 | 1,678 |
| Pakistan | 1,001 | 1,001 |
| Others (36 countries) | 4,665 | 5,053 |
| **Total** | **$58,712** | **$60,707** |

**Table 2.2: Overdue Amounts as of September 30, 1984**

Actual dollars

| Country | Original | Rescheduled | Total |
|---|---|---|---|
| Bolivia | $ 14,875 | $ • | $ 14,875 |
| Botswana | 456,900 | • | 456,900 |
| Colombia | 5,780 | • | 5,780 |
| Dominican Republic | 986,323 | • | 986,323 |
| Ecuador | 3,561,782 | 43,031 | 3,604,813 |
| Egypt | 175,272,826 | • | 175,272,826 |
| El Salvador | 9,074,650 | • | 9,074,650 |
| Ethiopia | 4,572,184 | • | 4,572,184 |
| Haiti | 3,703 | • | 3,703 |
| Honduras | 1,697,626 | • | 1,697,626 |
| Jamaica | 332,212 | • | 332,212 |
| Jordan | 61,921,326 | • | 61,921,326 |
| Liberia | 890,895 | 210,173 | 1,101,068 |
| Morocco | 3,259,180 | 5,626,811 | 8,885,991 |
| Nicaragua | 389,356 | • | 389,356 |
| Niger | 6,683 | • | 6,683 |
| Oman | 9,382 | • | 9,382 |
| Panama | 112,823 | • | 112,823 |
| Peru | 2,347,864 | 1,260,117 | 3,607,981 |
| Senegal | 612,655 | 44,556 | 657,211 |
| Somalia | 5,632,020 | • | 5,632,020 |
| Sudan | 12,853,315 | 1,344,921 | 14,198,236 |
| Tunisia | 3,150 | • | 3,150 |
| **Total** | **$284,017,510** | **$8,529,609** | **$292,547,119** |

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**Table 2.3: Year-End Outstanding Balances on Guaranteed Loans**

Dollars in thousands

| | Fiscal Years | | | |
|---|---|---|---|---|
| Country | 1981 | 1982 | 1983 | 1984 |
| Ecuador | $ • | $ • | $3,548 | $10,141 |
| Egypt | • | • | • | 175,273 |
| Jordan | • | 22,435 | 38,754 | 61,921 |
| Morocco | 6,977 | 28,774 | 41,491 | 77,295 |
| Peru | 8,872 | 7,068 | 7,068 | 16,735 |
| Sudan | 1,092 | 8,505 | 23,405 | 38,398 |
| Turkey | 233,813 | 320,233 | 387,084 | 359,382 |
| Others | 15,499 | 21,286 | 25,659 | 35,813 |
| **Total** | **$266,253** | **$408,301** | **$527,009** | **$774,958** |

**Table 2.4: Reserve Fund Balances**
(Fiscal years 1977-86)

Dollars in millions

| Fiscal year | Cash balance of funds | Cumulative contingent liability[a] | Percent |
|---|---|---|---|
| 1977 | $ 389 | $ 3,894 | 10.0 |
| 1978 | 548 | 5,478 | 10.0 |
| 1979 | 1,065 | 10,643 | 10.0 |
| 1980 | 1,170[b] | 12,093 | 9.6 |
| 1981 | 1,060 | 13,233 | 8.0 |
| 1982 | 919 | 15,662 | 5.9 |
| 1983 | 800 | 18,871 | 4.2 |
| 1984 | 552 | 22,556 | 2.4 |
| 1985 | 422[d] | 21,849 | 1.9 |
| 1986[c] | 144 | 21,065 | .7 |

[a] Includes future interest

[b] The balance of the fund after all outlays as of December 16, 1980. The total represented 25 percent of outstanding loans issued in FY 1974 and prior and 10 percent of outstanding loans issued subsequent to 1974. After December 16, 1980, Public Law 96-533 was passed, and no new appropriations were authorized to maintain the fund at the 10 percent level.

[c] Estimated

[d] The administration requested an increase of $274 million in the funding level of the reserve fund, and an increase of $109 million was appropriated. The amount of $422 million for 1985 includes the amount appropriated.

### TABLE 2-1
### OUTSTANDING DEBT FOR MAJOR DEBTOR COUNTRIES
### (PRINCIPAL AND INTEREST)
### (DOLLARS IN MILLIONS)

| | DEBT OUTSTANDING | |
|---|---|---|
| | GUARANTEED | TOTAL |
| ISRAEL | $23,458 | $24,089 |
| EGYPT | 13,427 | 13,427 |
| TURKEY | 5,119 | 6,708 |
| GREECE | 4,140 | 5,234 |
| SPAIN | 1,762 | 2,950 |
| KOREA | 1,398 | 2,127 |
| PAKISTAN | 934 | 1,516 |
| OTHERS | 4,013 | 5,305 |
| TOTAL | $54,251 | $61,356 |

### TABLE 2-2
### OVERDUE AMOUNTS
### AS OF SEPTEMBER 30, 1985

| | GUARANTEED | DIRECT | RESCHEDULED | TOTAL |
|---|---|---|---|---|
| BOLIVIA | $ 354,291 | $ | $ | $ 354,291 |
| BOTSWANA | 612,507 | | | 612,507 |
| COLOMBIA | 2,060,010 | | | 2,060,010 |
| DOMINICAN REPUBLIC | 2,420,608 | | | 2,420,608 |
| ECUADOR | 4,952,611 | | 388,693 | 5,341,304 |
| EGYPT | 451,238,149 | | | 451,238,149 |
| EL SALVADOR | 11,930,910 | | | 11,930,910 |
| ETHIOPIA | -- | 4,572,184 | | 4,572,184 |
| GREECE | 2,527,429 | | | 2,527,429 |
| HONDURAS | 540,712 | | | 540,712 |
| JORDAN | 72,852,311 | | | 72,852,311 |
| KENYA | 1,210,872 | | | 1,210,872 |
| LIBERIA | 1,490,325 | | 1,608,583 | 3,098,908 |
| MOROCCO | 40,672,500 | | 11,886,579 | 52,559,079 |
| NICARAGUA | 389,356 | | | 389,356 |
| NIGER | 32,193 | | 46,210 | 78,403 |
| OMAN | 11,249 | | | 11,249 |
| PERU | 6,018,036 | | 3,734,612 | 9,752,648 |
| SENEGAL | -- | | 253,332 | 253,332 |
| SUDAN | 12,854,099 | | 5,465,056 | 18,319,155 |
| TURKEY | 19,725,579 | | | 19,725,579 |
| ZAIRE | 2,673,511 | 6,102,203 | 4,720,327 | 13,496,041 |
| | $634,567,258 | $10,674,387 | $28,103,392 | $673,345,037 |

### TABLE 2-3
### YEAR-END OUTSTANDING BALANCES ON GUARANTEED LOANS
### (DOLLARS IN THOUSANDS)

| COUNTRY | FISCAL YEARS<br>1981 | 1982 | 1983 | 1984 | 1985 |
|---|---|---|---|---|---|
| ECUADOR | $ -- | $ -- | $ 3,548 | $ 10,141 | $ 11,229 |
| EGYPT | -- | -- | -- | 175,273 | 451,238 |
| JORDAN | -- | 22,435 | 38,754 | 61,921 | 72,852 |
| MOROCCO | 6,977 | 28,774 | 41,491 | 77,295 | 116,500 |
| PERU | 8,872 | 7,068 | 7,068 | 16,735 | 19,521 |
| SUDAN | 1,092 | 8,505 | 23,405 | 36,398 | 53,338 |
| TURKEY | 233,813 | 320,233 | 387,084 | 359,382 | 347,259 |
| OTHERS | 15,499 | 21,286 | 25,659 | 35,813 | 92,196 |
| TOTAL | $266,253 | $408,301 | $527,009 | $774,958 | $1,164,133 |

### TABLE 2-4
### RESERVE FUND BALANCES
### FISCAL YEARS 1977-87
### (DOLLARS IN MILLIONS)

| FISCAL YEAR | CASH BALANCE OF FUNDS | CUMULATIVE CONTINGENT LIABILITY[a] | PERCENT |
|---|---|---|---|
| 1977 | $ 389 | $ 3,894 | 10.0 |
| 1978 | 548 | 5,478 | 10.0 |
| 1979 | 1,065 | 10,643 | 10.0 |
| 1980 | 1,170[b] | 12,093 | 9.6 |
| 1981 | 1,060 | 13,233 | 8.0 |
| 1982 | 919 | 15,662 | 5.9 |
| 1983 | 800 | 18,871 | 4.2 |
| 1984 | 552 | 22,556 | 2.4 |
| 1985 | 271[d] | 21,828 | 1.2 |
| 1986[c] | 141 | 21,034 | .7 |
| 1987[c] | 104 | 20,214 | .5 |

---

[a] Excludes future interest

[b] The balance of the fund after all outlays as of December 16, 1980. The total represented 25 percent of outstanding loans issued in FY 1974 and 10 percent of outstanding loans issued subsequent to 1974. After December 16, 1980, Public Law 96 533 was passed, and no new appropriations were authorized to maintain the fund at the 10 percent level.

[c] Estimated

[d] The administration requested an increase of $274 million in the funding level of the reserve fund, and an increase of $109 million was appropriated. The amount of $271 million for 1985 includes the amount appropriated.

### FMS LOAN REPAYMENT PROBLEMS

*Question.* The GAO indicated that the Guaranty Reserve Fund would be depleted in FY 1987. Do you agree? What to you plan to do when the Fund is depleted?

Answer. We concur with DSAA estimates which project that the GRF will have a balance of approximately $105 million at the end of FY 1987. We have not requested a definite level of funding for GRF replenishment simply because that type of budgetary request has not been well received by the Congress. In addition, it is merely a "band-aid" approach to a longer term problem. Instead we intend to propose a permanent indefinite appropriation—as currently exists for some other Federal programs—which would automatically maintain the fiscal integrity of the Fund.

*Question. 1.* In his testimony, Undersecretary Schneider stated that "we cannot walk away from our responsibilities." I would like to call your attention to the Sudan, which receives substantial assistance from the United States. As you know, the government of Sudan has placed Nimeiri's former Vice President, Omar Tayeb, on trial for his role in the humanitarian airlift of Ethiopian Jews out of Sudan. It is my understanding that the prosecutor is seeking the death penalty. Given our own role in this humanitarian airlift, what responsibilities do we have toward Mr. Tayeb? What are we doing?

Answer. The prosecution wrapped up its case on March 9, and the court will deliver its verdict on April 5. In addition to involvement with the Falasha airlift—deemed treason because Sudan technically has been at war with Israel since 1967?—Mr. Tayeb is also charged with corruption.

We have followed the trial of Mr. Tayeb closely. We have expressed our concern that Mr. Tayeb receive due process and that the trial not become a cover for a political vendetta against him. Since the trial began last fall, we have repeatedly stressed to the Government of Sudan the humanitarian nature of the Falasha airlift.

*Question 2.* If he is convicted and certainly if he is executed, what would the Administration propose to do regarding our assistance to the Sudan?

Answer. In view of the fact that the court is now deliberating on a verdict for Mr. Tayeb, we would prefer not to say anything for the record that could be construed as prejudicial.

### MOZAMBIQUE

*Question.* "Why does the State Department propose to give 25 million American dollars to help Marxist Mozambique . . . in the same year it seeks aid for anticommunist insurgents all over the world?"

Answer. The intent of our assistance to Freedom Fighters is to stop the spread of communism. What we see in Mozambique today is a government that, having seen communism fail to develop a healthy economy, is backing away from the Soviet model and moving toward non-alignment supported by adoption of a mixed economy. Our assistance to Mozambique is designed to encourage and abet this favorable development. Supporting the insurgents in this context would be counterproductive since this would constitute U.S. rejection of Mozambique's move toward the West, force the government into heavier reliance on Soviet military assistance, and result in greater Soviet influence over the country's domestic and foreign politics.

### ZIMBABWE

*Question.* "Why is $25 million proposed for Zimbabwe—a one party state that represses its opposition, arrests and tortures its opponents and consistently opposes U.S. foreign policy—in the same year State proposes nothing for the reliably pro-Western Ivory Coast?"

Answer. U.S. aid to Zimbabwe has declined substantially as the needs of that country have decreased. However, the aid still supports a large private sector and the government's successful agricultural policies. We provide the Ivory Coast some assistance through regional programs, but do not have a bilateral program there due to the relatively high per capita income that the country enjoys.

### SEYCHELLES

*Question.* "And . . . why is more than $2 million proposed for the Seychelles, which provides basing rights and other services to the Soviet Union, while less than half that amount is proposed for the truly neutral, independent Comoros?"

Answer. Our $2 million ESF program in the Seychelles supports the presence of a strategic U.S. Air Force satellite tracking station located in Seychelles' main island of Mahe. Current levels of ESF funding were established in the course of negotiations for the tracking station lease. The U.S. has no such facility in the Comoros, a more recently independent state, with which we have warm relations and for budgetary reasons, only a nascent assistance program.

### GHANA

*Question.* "Why does the State department seek $18 million for Ghana's government, which has supported Soviet policies in Africa and elsewhere and has welcomed several thousand Soviet bloc troops, but less than one third that amount for neighboring Togo, which shows goodwill to the West. . . .?"

Answer. We are not aware of any Soviet bloc troops stationed in Ghana. Although we have a wide range of differences with the present Government of Ghana, the people of Ghana remain pro-West and pro-American. We do not believe they should suffer as a result of our differences with the current regime. Our assistance program in Ghana is designed to benefit the Ghanaian people and to support a market-oriented economic reform program adopted by the Government of Ghana in 1983. The bulk of our assistance to Ghana in FY 86 ($14.7 out of $19.6 million) will go for PL-480 Title I and II food and commodity assistance. $5 million is programmed for development assistance projects in family planning and agriculture. A $315,000 IMET grant is designed to promote professional contact with the Ghanaian military.

The difference in the amount of our aid programs in Ghana and Togo is a reflection in part of the population differences between the two countries. We provide significantly more assistance to Togo per capita ($2.60) than to Ghana ($1.50). Also, much more of our assistance to Togo is in Development Assistance ($3 million) whereas the bulk of our assistance to Ghana has been in PL-480 programs.

## Questions Submitted by Mr. Mrazek

### KOREA—SECURITY ASSISTANCE OVERVIEW

*Question.* 1. What is the total annual cost of the U.S. troop commitment to South Korea?

2. Please provide a numerical breakdown of all relevant expenses for 1985, including but not limited to the cost of supplying and maintaining U.S. troops in Korea, military construction costs, and military exercises.

Answers. The Department of Defense will provide the requested information to the Committee on a classified basis.

EXECUTIVE SESSION

THURSDAY, MARCH 6, 1986.

## ANTI-TERRORISM OVERVIEW

WITNESSES

**HON. ROBERT B. OAKLEY, ACTING AMBASSADOR-AT-LARGE FOR COUNTERTERRORISM, DEPARTMENT OF STATE**

**JAMES H. MICHEL, PRINCIPAL DEPUTY ASSISTANT SECRETARY, BUREAU OF INTER-AMERICAN AFFAIRS, DEPARTMENT OF STATE**

**FRANK FULGHAM, DIRECTOR, ANTI-TERRORISM PROGRAM, DEPARTMENT OF STATE**

Mr. MCHUGH. As you probably have gathered, our chairman is involved at the moment on the Floor with a dairy-related bill, which is critical to Wisconsin, and we expect him along shortly.

This afternoon, the committee will review: one, the Administration's fiscal year 1987 request for anti-terrorism assistance; two, the $4.84 million requested as fiscal year 1986 supplemental funding for anti-terrorism programs; and, three, the use of fiscal year 1987 MAP and FMS funds for police training and equipment associated with anti-terrorism.

Our witness today is Ambassador Robert B. Oakley, Acting Ambassador-at-Large for Counterterrorism. Joining him at the witness table is James Michel, Principal Deputy Assistant Secretary for Inter-American Affairs.

Ambassador Oakley, I understand you have a statement, which we will place in the record. Please summarize as you wish and then we will have questions.

Mr. OAKLEY. I am pleased to be here today to testify on the anti-terrorism assistance program, and to explain our fiscal year 1987 budget request. I have provided the committee with a full statement which I would like to submit for the record, while limiting myself to a brief summary statement.

In the short time since its inauguration in 1984, the ATA program has become one of our most effective tools to improve international counterterrorism cooperation by strengthening the dialogue with other states and providing technical assistance in this field through training.

The need for an anti-terrorism assistance program is clear. During 1985, the number of international terrorist incidents increased to 812, an increase of 33 percent over 1984 and up over 50 percent from the average number of incidents each year for the previous five years.

1985 was marked by such dramatic events as the hijackings of TWA 847, the Achille Lauro and Egyptair 648, the murder of four off-duty Embassy Marine Guards in El Salvador, and the incidents at the Rome and Vienna airports.

23 Americans were killed and 139 injured in 1985. Since nearly all terrorist incidents occur outside the United States—only seven inside the U.S. last year—and we must look primarily for their resolution to other governments which have the legal and political responsibility for the safety of American facilities and personnel overseas, and who also have the ability to work with us in throttling down terrorism generally, and keeping it abroad, rather than allowing it to get to this country.

The ATA program was created to strengthen the capability and determination of like-minded governments to combat terrorism, both alone and in cooperation with the United States.

We have pursued this goal in two ways:

First, we have concentrated on establishing a policy dialogue with senior foreign officials on the importance of closer cooperation in sharing information about terrorism and developing joint efforts.

Second, we have focused on training key personnel from appropriate civilian law enforcement and security agencies from those countries. The training process has focused on improving technical skills and expertise, while at the same time emphasizing the importance of human rights in the areas of law enforcement and counterterrorism.

We are pleased with the progress of the program in 1985. 17 new countries participated in the introductory seminars, bringing the total to 32 countries which have joined the program.

Last year, countries like Israel, Greece, the Gulf Cooperative Council, Pakistan, Tunisia, Honduras and Colombia began to participate. A total of over 1800 officials have now participated in over 100 specialized anti-terrorism training courses. Almost two years since the first course was held, some 300 others.

The ATA program made effective use of the entire $5 million appropriation for fiscal year 1985, its first full year of operation.

Our original request for $5 million for fiscal year 1986 was increased by the Congress last summer to $7.42 million. After reductions in accordance with Gramm-Rudman, this amounted to $7.1 million. An additional $4.84 million is pending in the fiscal year 1986 diplomatic security supplemental request. We are requesting $9.84 for fiscal year 1987.

The ATA program is, and must continue to be, primarily a training program. At the present time, however, we are limited to a maximum of $325,000 for training-related equipment assistance.

Last year, we provided a total of $700,000 with the Congressional approval to reprogram 375,000.

We see a pressing need for agreement with appropriate committees of the Congress on a change in the authorizing legislation which would permit a substantial increase in the amount allowed, within the overall budget, for equipment grants.

Removal of restrictions on provision of some munitions list items by the Congress in 1985, small arms, small arms ammunition, and protective equipment, and an increased emphasis on civil aviation and airport security which requires training with and utilization of sophisticated and expensive equipment such as X-ray and metal detection devices, have combined to make the present limitation clearly inadequate, and without that equipment, the people that are going to be trained will not be able to do a very good job.

In this fiscal year, we intend to spend $500,000 of ATA money in El Salvador, of which $450,000 will be training. This is the ATA part of the special counterterrorism program with 4.5 million reprogrammed for military assistance. It will go primarily to build up the civilian counterterrorist and police capability in the City of San Salvador and the suburbs, which is important because of what intelligence says lies ahead this year.

This sums up my oral statement, Mr. Chairman.

[The full statement of Mr. Oakley follows:]

A STATEMENT BY

AMBASSADOR ROBERT B. OAKLEY

ACTING AMBASSADOR-AT-LARGE FOR COUNTER- TERRORISM

BEFORE

THE SUBCOMMITTEE ON FOREIGN OPERATIONS

OF THE APPROPRIATIONS COMMITTEE

UNITED STATES HOUSE OF REPRESENTATIVES

MARCH 6, 1986

**

# STATEMENT TO THE SUBCOMMITTEE ON FOREIGN OPERATIONS HOUSE APPROPRIATIONS COMMITTEE
BY
ROBERT B. OAKELY
ACTING AMBASSADOR AT LARGE FOR COUNTER-TERRORISM

MARCH 6, 1986

I am very pleased to be with the subcommittee today to explain our budget request for Fiscal Year 1987 for the Anti-Terrorism Assistance (ATA) Program. In the short time since its inauguration in 1984, the ATA Program has become one of our most effective tools to improve international counter-terrorism cooperation by strengthening the dialogue with other states and providing technical assistance in this field through training.

We are requesting $9.84 million for Fiscal Year 1987. As you may recall, our original request for $5 million for FY 86 was increased by the Congress last summer to $7.42 million. After reductions in accordance with the Balanced Budget and Emergency Deficit Control Act of 1985, this amounted to $7.10 million for FY 86. An additional $4.84 million is pending in the FY 86 (Diplomatic Security) supplemental request.

During 1985, the number of international terrorism incidents increased to 812, an increase of 33 % over the 600 incidents for 1984 and up over 50 % from the average number of incidents each year for the previous five years. Since nearly all of the incidents occur outside the U.S., we must look primarily to other governments for the resolution of these incidents. They have the legal and political responsibility for the safety and security of American diplomatic, military and business facilities and personnel and tourists in their country just as the U.S. has this responsibility within our own country. Success in countering terrorism can increase only through closer cooperation with other governments in a well-organized common effort.

The ATA Program was created to strengthen the capability and determination of like-minded governments to combat terrorism, both alone and in cooperation with the United States. The ATA program follows two basic approaches:

--First, we have concentrated on establishing a policy dialogue with senior officials in selected countries on the importance of closer cooperation in sharing intelligence about terrorism and developing joint efforts.

--Second, we have focused on training key personnel from appropriate civilian law enforcement and security agencies from those countries. The training process has focused not only on improving technical skills and expertise, but has also placed equal emphasis upon familiarizing foreign officials with the modern, humane techniques used by U.S. federal, state and local police agencies in dealing with sensitive and dangerous problem areas such as hostage rescue and VIP protection.

We are very pleased with the progress of the program during 1985. As we noted in our annual report, highlights of the program for the past year have included:

--Seventeen new countries participated in the introductory seminars in the U.S., bringing the total to 32 countries which have joined the program.

--A total of over 1800 officials have now participated in over 100 separate specialized anti-terrorism training courses in the 18 months since the first course began. Over 260 more have participated in the Phase I executive seminar.

--The number of agencies and organizations in the U.S. which have actually conducted the training courses is growing. ATA courses to date have been offered by seven different federal goverment agencies, six state and local police agencies, four professional organizations, and four universities and private firms.

--The U.S. procured $700,000 in training-related equipment ($375,000 through reprogramming) for participating countries during FY 85, most of which was for civil aviation security (walk-through and hand-held metal detectors and cargo and carry-on baggage x-ray devices). This reprogramming was discussed in letters to the Senate Foreign Relations Committee, Senate Committee on Appropriations, House Committee on Appropriations, and the House Committee on Foreign Affairs dated September 11, 1985.

--Authority for the operational management of the program was transferred to the Bureau of Diplomatic Security in January 1986. The Office of the Ambassador-at-Large retains responsibility for policy guidance.

--The ATA program made effective use of the entire $5 million appropriation for FY 1985, its first full year of operation.

Among the most popular courses offered during the year were civil aviation security, VIP protection, crisis management, and hostage negotiation and rescue. New courses introduced included post-blast investigation, building security, and pipeline security.

A significant change in the ATA legislation was approved by the Congress in 1985 when it authorized the provision of certain previously prohibited items on the Munitions List established pursuant to the Arms Export Control Act. Items affected are small arms in Category I, small arms ammunition in Category II, and protective equipment in Category X, if they are directly related to anti-terrorism training.

## The Program for 1986:

Priority objectives for the program in 1986 are to:

--encourage appropriate new countries to participate in the program;

--continue emphasis on civil aviation, airport and maritime security;

--expand program evaluation and assessment.

--modify courses to meet the specific needs of individual countries; and

--increase coordination of anti-terrorism training programs within the U.S. Government

With respect to the first objective above, it often takes considerable time and persuasion to overcome inertia or reluctance on the part of countries whose participation we consider important. Some governments have been convinced to participate only when a terrorist act has taken place in or near their territory. This has been particularly true in the Mediterranean area and the Persian Gulf where there are special political considerations. Nevertheless, as we have noted, such countries as Israel, Egypt, Tunisia, the GCC States, Greece and Turkey were actively involved in ATA during 1985.

With Congressional approval, we are now prepared to move ahead with the ATA Program for El Salvador, as stated in a November 19, 1985 letter to the Authorization and Appropriation Committees of the Congress.

As soon as our Embassy has coordinated acceptable dates with the Government of El Salvador and Congressional notification requirements are satisfied, we plan to initiate two specific training courses in the U.S.

First, the Senior Law Enforcement/Counter-Terrorist Seminar, a course for five to ten participants, will focus on modern operational methods and police structure. It will consist of 14 days of intense on-the-scene visits and discussions of modern police organization, tactics, planning procedures, analytic systems, and logistics. Throughout the course, a strong emphasis will be put on the importance of human rights and community relations.

Second, the Counter-Terrorist Patrol Operations course will provide 30 days instruction relating to the patrol division of a large police department. Ten to twenty participants (shift and patrol area commanders) will learn how a patrol division is organized by time and geography, as well as how patrol officers are trained, briefed, supervised and coordinated.

These two courses will provide the basic knowledge to enable the Salvadoran police to organize, operate and control a street patrol force designed to suppress and disrupt terrorist activity.

Three additional courses will be implemented as soon as appropriate Salvadoran personnel have been identified and become available:

Counter-Terrorist Command and Control Procedures
Counter-Terrorism Training Skills
Human Relations and Internal Disciplinary Systems

This basic curriculum of five courses, with limited accompanying equipment grants, will serve as a foundation upon which subsequent ATA training can build and expand.

The DOD equipment package for El Salvador (vehicles and communications), as described in the November 19, 1985 letter, is directly related to the ATA training. Together, they will enable the Government of El Salvador to begin to function in operational areas that have desperately needed attention for a long time. This includes such activities as despatching motorized police patrols and reaction forces, using the communications equipment to coordinate as well as maintain comand and control of those activities, primarily for the city and suburbs of San Salvador. The planned ATA training thus focuses on instruction which is directly related to these operations. It will emphasize that a knowledge of human relations, together with the ability to discipline its own officers, is essential if there is to be increased trust and support from the population, without which no police force can operate effectively against terrorism.

The FY 1987 budget request covers the following categories:

1. Program Management: $370,000. Program management funds provide for staff travel and transportation, rental of office equipment and supplies. The staff manages and coordinates all phases of the program, including promoting,

presenting and explaining the goals of the program to eligible countries; developing and coordinating the executive seminars (Phase I); participates as the team leader of the training program design teams (Phase II); and develops and schedules the training courses throughout the U.S. for the participating countries.

2. Executive Seminars: $1,075,000. Phase I seminars will be conducted for up to 15 countries with 8-15 senior officials in each delegation. The funding provides for transportation and per diem for the participants and for program support costs. (15 countries participated in Phase I in FY 84, 17 in FY 85 and 15 are projected for FY 86.)

3. Training Assessments: $162,000. Up to 15 Phase II teams of 3-5 members will conduct training design assessments overseas. Experts to accompany the Department of State team leader will be drawn from U.S. Customs, BATF, DOT, FAA, and other participating federal, state and local agencies.

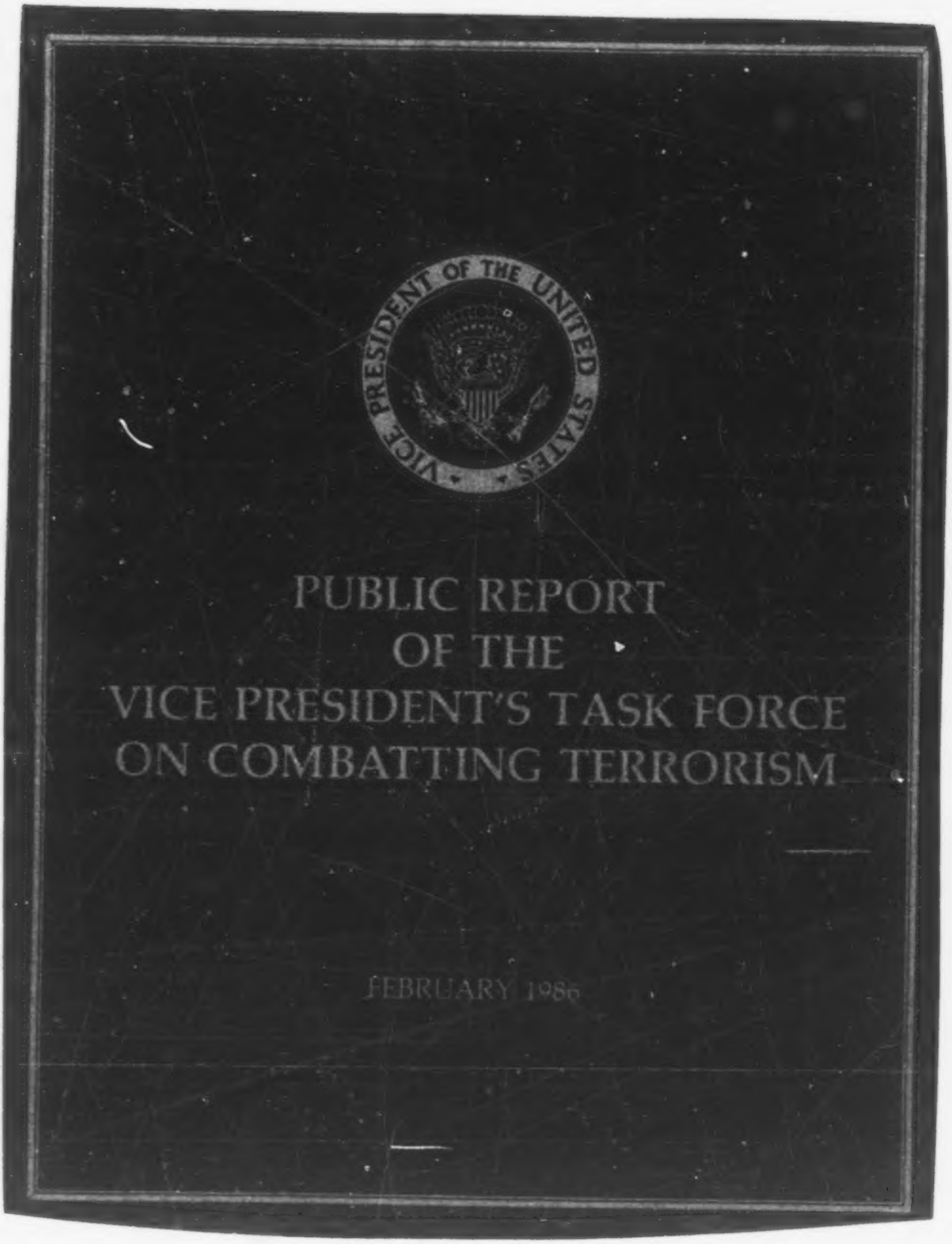
4. Training Courses: $7,908,000. This figure reflects a continuing expansion of the specific training programs of Phase III as more and more participating countries complete the initial phases and move into an actual training cycle. We anticipate that approximately 2,000 individuals will be

trained in FY 87, a 68% increase over FY 86. This estimate takes into consideration class size, type of training, and the ability of the participating country to make students available for extended periods of time. In addition to an increase in the number of individuals trained in FY 87, there will be an increase in the length of some courses, such as Civil Aviation Security, expansion of such highly specialized courses as Bomb Detector Dog and Bomb Render Safe, and a continuing general increase in the level of comprehensiveness and sophistication.

5. Equipment Grants: presently limited to $325,000 per year, this poses a problem. Upon completion of a number of specialized ATA training courses, participating governments may be provided appropriate equipment assistance. This has usually consisted of metal detectors and x-ray machines for airport and courtroom security, and bomb disposal equipment The limit will need to be raised as additional countries complete Phase III training courses.

ATA is, and must continue to be, primarily a training program. However, we see an urgent and immediate need for agreement with appropriate committees of the Congress on a change in the authorizing legislation which would permit a substantial increase in the amount allowed, within the overall budget, for training-related equipment assistance. Removal of restrictions on provision of some Munitions List items by the Congress in 1985, and an increased emphasis on civil aviation and airport security which requires training with increasingly sophisticated and expensive equipment such as x-ray and metal detection devices, have combined to make the present $325,000 limitation clearly inadequate.

Many of the governments participating in the program simply do not have funds available in their limited budgets for this sort of equipment, without which much of the training received will be of greatly diminished value. The existing $325,000 limitation might well be applied to the newly approved Munitions List items of a lethal nature, and a new upper limit established to cover non-lethal equipment such as airport x-ray machines. These combined figures, for example, could be set at not more than 25% of the total ATA program budget. This would permit us a measure of flexibility, enable us to support our training efforts at an adequate level, and meet the minimum equipment needs for an effective program by the governments of the personnel being trained. We intend to consult closely with this and other appropriate committees to develop an acceptable legislative change on this issue.



PUBLIC REPORT
OF THE
VICE PRESIDENT'S TASK FORCE
ON COMBATTING TERRORISM

FEBRUARY 1986

VICE PRESIDENT OF THE UNITED STATES

Fellow Americans:

As 1985 closed, the world was shocked by yet another savage terrorist act. The violent attacks at the Rome and Vienna airports left 114 wounded and 18 dead, five of whom were Americans. One was a young American girl of eleven.

Earlier in the year we saw the hijackings of TWA Flight 847 and the cruise ship *Achille Lauro,* where innocent Americans were brutally murdered by international outlaws. Such vicious attacks are representative of what has become a growing trend toward international terrorism over the past decade.

Concerned about the increasing loss of American lives, as well as repeated terrorist threats against our citizens, last July President Reagan asked me to chair a Cabinet-level Task Force on Combatting Terrorism.

Comprised of 14 senior government officials with major responsibilities for our national program to combat terrorism, the Task Force spent the last half of 1985 reviewing and evaluating current U.S. policy and programs.

One of the first things we discovered is that Americans view terrorism as one of the most serious problems facing our government, ranking it alongside such issues as the budget deficit and strategic arms control. They want assurance that the United States is prepared to handle the growing threat of terrorism, that we have a policy and response mechanism in place, and that we are working to improve our system. Our citizens' concern is justified, for terrorism has grown at an alarming rate. In 1985 alone there were 812 international incidents, with a loss of 926 lives, including 23 Americans.

Clearly the growing threat from increased terrorist activities against U.S. citizens and interests abroad calls for a strengthening of our own programs as well as greater cooperation from foreign governments. Domestically, although there were only seven terrorist incidents in the United States last year, the potential for future problems exists here at home and we must be well prepared.

When President Reagan asked our Task Force to review the nation's program to combat terrorism, it was not primarily a mandate to correct specific deficiencies, but one to reassess U.S. priorities and policies, to ensure that current programs make the best use of available assets, and to determine if our national program is properly coordinated to achieve the most effective results.

Our Task Force was briefed by more than 25 government agencies, visited 14 operations centers to observe our capability firsthand, met with over 100 statesmen, military officers, scholars and law enforcement officials, and traveled to embassies and military commands throughout the world where discussions with both U.S. and foreign officials were conducted.

I personally met with many members of Congress, airline chief executive officers, media executives, and former Cabinet officials and diplomats.

Our conclusion: the U.S. policy and program to combat terrorism is tough and resolute. We firmly oppose terrorism in all forms and wherever it takes place. We are prepared to act in concert with other nations or alone to prevent or respond to terrorist acts. We will make no concessions to terrorists. At the same time, we will use every available resource to gain the safe return of American citizens who are held hostage.

Our national program is well-conceived and working. The United States currently has in place antiterrorism activities in virtually every federal department and agency. Specific agencies have been assigned to respond to any threat or attack directed at our citizens whether on foreign soil, here at home, in the air or at sea.

To build on these existing safeguards, our Task Force made a number of recommendations to the President in December 1985. The following public report on terrorism includes those unclassified proposals dealing with improved coordination among government agencies, plus the creation of a full-time position on the National Security Council staff and the establishment of a consolidated intelligence center on terrorism.

The Task Force also is recommending strong Administration support of proposed legislation calling for the death penalty against any terrorist who kills an American hostage. Additional proposals cover increased cooperation with other governments and outline expanded communications programs with families of hostage victims, the media and the general public.

While international terrorism poses a complex, dangerous threat for which there is no quick or easy solution, I believe that the recommendations of our Task Force will significantly improve America's capability for combatting terrorism. As long as vicious attacks continue, terrorism will remain a top priority of this Administration.

# PUBLIC REPORT
# OF THE
# VICE PRESIDENT'S TASK FORCE
# ON COMBATTING TERRORISM

FEBRUARY 1986

For sale by the Superintendent of Documents, U.S. Government Printing Office
Washington, D.C. 20402

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# Significant 1985 Terrorist Incidents Involving U.S. Citizens

February 2 **Greece**

A nightclub frequented by U.S. servicemen near Athens is bombed. Seventy-eight people are injured including 69 Americans.

April 12 **Spain**

Eighteen people are killed and 37 wounded when a bomb destroys a family restaurant in a suburb of Madrid. Seven Americans are injured.

June 14 **Greece**

TWA Flight 847 is skyjacked by Shi'ite terrorists minutes after takeoff from Athens. The ordeal lasts 17 days. The 145 passengers include 104 Americans.

A U.S. Navy diver is tortured and shot. His body is thrown out of the aircraft at Beirut Airport, Lebanon.

June 19 **El Salvador**

Four U.S. Marines and two American businessmen are gunned down at an outdoor cafe in San Salvador. A total of 13 people are murdered.

June 23 **Over the Atlantic Ocean**

An Air-India flight explodes over the Atlantic Ocean, killing everyone aboard including four Americans.

August 8 **West Germany**

A powerful car bomb explodes at the U.S. Rhein-Main Air Base near Frankfurt. The blast kills one U.S. airman and the wife of another. Fifteen other Americans are injured.

Minutes before the blast, the body of an American soldier is discovered near Wiesbaden. His identify card had been stolen. Authorities believe the I.D. was used to gain access for the bomb-laden car at Rhein-Main Air Base.

October 7 **The Mediterranean Sea, Near Egypt**

The Italian cruise ship *Achille Lauro* is hijacked by Palestinian terrorists. A 69-year-old American tourist is murdered and thrown overboard.

The four terrorists are apprehended when U.S. Navy fighters intercept the aircraft carrying them to safehaven.

and Felix Throughout

November 23 **Greece**

Egyptair Flight 648 enroute to Cairo is skyjacked 20 minutes after takeoff from Athens. One U.S. Air Force civilian employee is murdered and two other Americans are seriously wounded. A total of 60 persons are killed during the rescue effort.

November 24 **West Germany**

A U.S. military shopping mall in Frankfurt is bombed, wounding 32 people including 23 Americans.

December 27 **Italy**

Rome's airport is attacked by terrorists armed with grenades and automatic rifles. Seventy-three people are wounded, 15 are killed, including 5 Americans. One of the Americans is an 11-year-old girl.

**Austria**

Minutes after the Rome massacre, terrorists strike the Vienna Airport. Three are killed and 41 wounded. Two of the wounded are Americans.

December 31 **Lebanon**

At the close of 1985, six American citizens continue to be held hostage.

## 1985 U.S. Victims of International Terrorism

23 Dead
160 Wounded

# The Growing Threat of Terrorism

> *"We the people of the United States, in order to form a more perfect union, establish justice, insure domestic tranquility, provide for the common defense, promote the general welfare, and secure the blessings of liberty to ourselves and our posterity, do ordain and establish this Constitution for the United States of America."*

The basic principles of freedom, justice and concern for human life on which our nation was founded have survived major threats during the course of America's history. Today, we face a unique and pervasive challenge to these ideals in the form of terrorism, an increasingly serious threat to the United States and its friends and allies around the world.

## THE NATURE OF TERRORISM

Terrorism is a phenomenon that is easier to describe than define. It is the unlawful use or threat of violence against persons or property to further political or social objectives. It is generally intended to intimidate or coerce a government, individuals or groups to modify their behavior or policies.

The terrorist's methods may include hostage-taking, aircraft piracy or sabotage, assassination, threats, hoaxes, indiscriminate bombings or shootings. Yet, most victims of terrorism seldom have a role in either causing or affecting the terrorist's grievances.

Some experts see terrorism as the lower end of the warfare spectrum, a form of low-intensity, unconventional aggression. Others, however, believe that referring to it as war rather than criminal activity lends dignity to terrorists and places their acts in the context of accepted international behavior.

While neither the United States nor the United Nations has adopted official definitions of terrorism, Americans readily recognize the bombing of an embassy, political hostage-taking and most hijackings of an aircraft as terrorist acts. They realize that terrorism needs an audience; that it is propaganda designed to shock and stun them, that it is behavior that is uncivilized and lacks respect for human life. They also believe that terrorism constitutes a growing danger to our system, beliefs and policies worldwide.

## PROFILE OF A TERRORIST

The motivations of those who engage in terrorism are many and varied, with activities spanning industrial societies to underdeveloped regions. Fully 60 percent of the Third World population is under 20 years of age; half are 15 years or less. These population pressures create a volatile mixture of youthful aspirations that when coupled with economic and political frustrations help form a large pool of potential terrorists. Many terrorists have a deep belief in the justice of their cause. They are tough and vicious and may have little regard for their own lives or those of their victims in attempting to achieve their goals. Others may even be hired assassins.

Terrorists generally get their weapons from a largely unregulated international arms market but also resort at times to illegal methods. They acquire timely information on targets and countermeasures. Lately, they have resorted to unprecedented violent attacks and, when government security efforts against them become more effective, they simply shift to easier targets.

While there are several ways to categorize terrorists, for purposes of this report three main categories are used: self-supported, state-sponsored or aided, and those individuals who may engage in terrorism for limited tactical purposes.

Self-supported terrorists primarily rely on their own initiatives, such as extortion, kidnapping, bank robberies and narcotics trafficking to support their activities.

Terrorists lacking state sponsorship, aid or safehaven tend to be extremely security conscious, keeping their numbers small to avoid penetration efforts.

State-sponsored or aided terrorist groups frequently are larger in numbers, have the advantage of protection by state agencies and are able to access state intelligence resources. Because of this host country-provided safehaven and the compartmented operations of terrorist organizations, it is extremely difficult to penetrate such groups. Moreover, they are subject to limited control by their sponsors and may be expected to carry out attacks for them.

The reasons for state support and use of such groups are many. Terrorism has become another means of conducting foreign affairs. Such terrorists are agents whose association the state can easily deny. Use of terrorism by the country entails few risks, and constitutes strong-arm, low-budget foreign policy. Growing government assistance in arms, explosives, communications, travel documents, safehaven and training of fanatics are the types of aid that state-supported terrorists receive.

Some individuals or groups may choose to engage in terrorist violence in the context of activities such as national insurgency, especially when they may be losing a conflict, to try to create a special effect, embarrass opposing leadership, or change the pace of events.

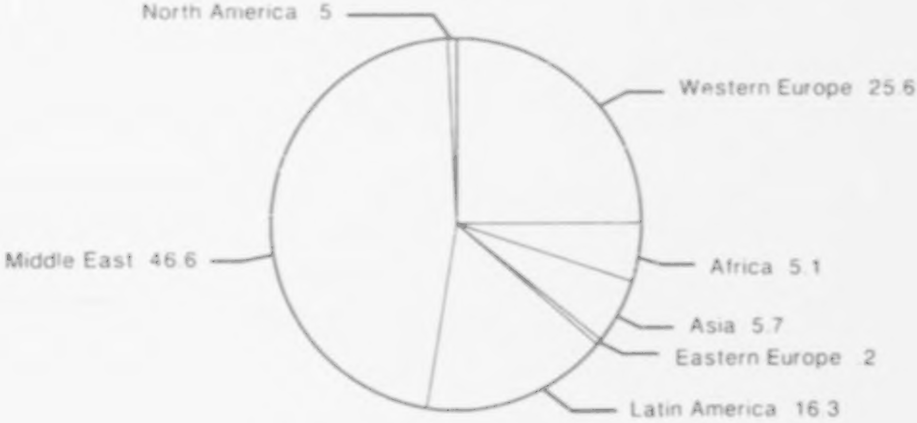
The most deadly terrorists continue to operate in and from the Middle East. In 1985 they were involved in roughly 50 percent of the total worldwide terrorist incidents. The two main sources are militant Shi'ites from various Middle Eastern countries, especially Lebanon, supported to varying degrees by Iran or Syria; and radical Palestinian elements, principally offshoots of the Palestine Liberation Organization (PLO), often with direct support from Libya, Syria or Iran. Others, such as independent agents of governments like Libya, also conduct terrorist operations.

Middle East terrorist groups have three main targets: Israel; Western governments and citizens, particularly the United States, France, Italy, and the United Kingdom; and moderate Arab governments and officials, particularly those of Jordan, Egypt, Kuwait and Saudi Arabia.

Many terrorist organizations have continued to operate in Europe during the past decade, including the Italian Red Brigade, French Direct Action, German Red Army Faction and the Provisional Irish Republican Army. The latter has been and remains the most active.

# Geographic Distribution of International Terrorist Incidents

## 1985



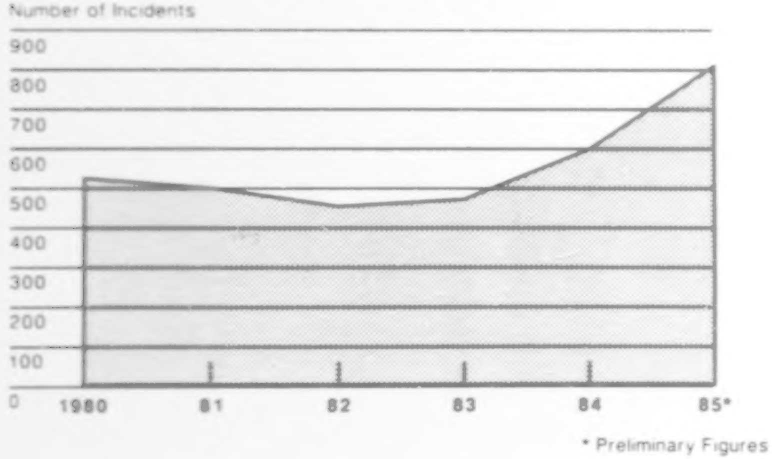
Established leftist groups in Spain, Portugal and Greece continue their terrorist campaigns, while a new group has surfaced in Belgium, a country hitherto relatively free from terrorism. Recently, there have been disturbing indications that leftwing terrorists of several nationalities are beginning to cooperate and coordinate their attacks. Of the 812 incidents worldwide in 1985, over 200 took place in Western Europe.

In Latin America, social, economic and political turmoil have prolonged existing patterns of insurgency as well as international and domestic terrorism in several countries, particularly El Salvador, Colombia, Guatemala, Chile and Peru. Nicaragua and Cuba also have been implicated in terrorist activity in the region. During 1985 there were more terrorist incidents (86) directed at U.S. citizens in Latin America than anywhere else.

Certain governments have demonstrated a growing propensity to use, support and exploit terrorism as an instrument of national policy. This trend toward the alignment of interests between certain states and terrorist groups has markedly elevated threat levels worldwide, as state and financial resources have expanded terrorists' capabilities.

## INTERNATIONAL TERRORISM

Terrorism is as old as recorded history, but the past two decades have witnessed a dramatic increase in international terrorist acts by people and by governments in the pursuit of their goals. The past year saw the number of terrorist incidents reach a high of 812.


International Terrorist Incidents
1980-1985

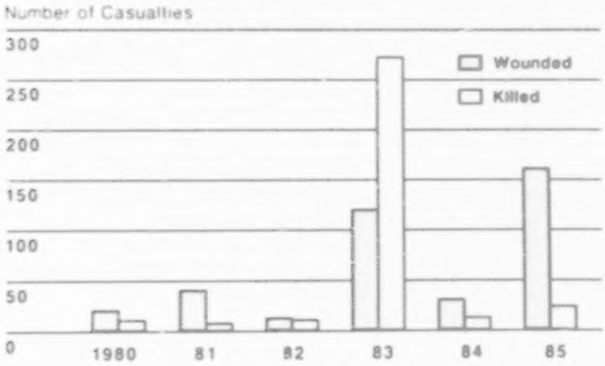
Half of the worldwide incidents in the 1980s were aimed at only 10 countries; one-third of the total were targeted directly at the United States. The number of terrorist acts has generally risen since official statistics were first compiled in 1968, with a trend toward bloodier incidents with more fatalities. Attacks caused 20 fatalities in 1968 compared to 926 in 1985.

Incidents in 1985 demonstrated that terrorism is increasingly directed against the Western democracies. The June 14, 1985, hijacking of TWA Flight 847 shortly after it left Athens was the first hijacking of a U.S. airliner in the Middle East since 1970. In addition, the hijackings of Egyptair Flight 648 and the *Achille Lauro,* the bombing of a restaurant on the outskirts of Madrid frequented by American servicemen and the shooting of the off-duty Marine Corps personnel in El Salvador demonstrate that Americans are being specifically targeted. The year ended with the brutal attacks in the Vienna and Rome airports where five Americans were murdered.

During the past decade, terrorists have attacked U.S. officials or installations abroad approximately once every 17 days. In the past 17 years, terrorists have killed as many U.S. diplomats as were killed in the previous 180 years.

## U.S. Casualties Resulting From International Terrorist Incidents

1980-1985



In 1982, a total of 57 attacks were directed against U.S. military personnel, resulting in two deaths. In 1983, even more incidents occurred (65), and 241 deaths resulted from one incident. In that bombing of the U.S. Marine barracks in Beirut, the United States lost nearly as many servicemen as the British lost in the entire Falklands campaign.

### DOMESTIC VULNERABILITY

While the number of terrorist acts outside our borders increased dramatically in the last three years, incidents within the United States have declined from 51 acts in 1982 to only seven in 1985. And while 23 Americans overseas lost their lives to terrorists last year, only two citizens were killed within our own borders. This can be attributed in part to the success of the Department of Justice and Federal Bureau of Investigation (FBI) in their counterterrorist activities. Additionally, it appears that international terrorist groups find it easier and safer to target Americans overseas rather than within the United States. In 1985, there were 23 terrorist incidents prevented in the United States by the timely action of the FBI and other law enforcement agencies.

FBI efforts in 1985 included the foiling of a plot to assassinate Prime Minister Rajiv Ghandi of India while visiting the United States; the uncovering of a pro-Qaddafi conspiracy to carry out three assassinations and to bomb strategic locations in the United States; the interdiction of a Sikh assassination plot in New Orleans; and the prevention of planned bombings in India by the same group.

## Terrorist Incidents in the United States

### 1980-1985

| Date | Total Incidents | Killed | Injured |
|---|---|---|---|
| 1980 | 29 | 1 | 19 |
| 1981 | 42 | 1 | 4 |
| 1982 | 51 | 7 | 26 |
| 1983 | 31 | 6 | 4 |
| 1984 | 13 | 0 | 0 |
| 1985 | 7 | 2 | 10 |

Over the years the FBI has become increasingly involved in "special events" of national and international interest that take place in the United States and which could serve as an attractive target against terrorism. The Pan American games in San Juan, Puerto Rico, were the first such event where the FBI took precautions against terrorism. Others have been the New Orleans World's Fair and the two 1984 national political conventions in San Francisco and Dallas.

The 1984 Olympic Games in Los Angeles, with a record 140 countries participating, received close scrutiny by the FBI and other federal agencies. The federal law enforcement community worked in conjunction with local and state officials to coordinate the flow of intelligence regarding possible terrorist movements and attacks. Contingency plans were developed for an emergency response to any incident that might have occurred.

Despite this outstanding track record in combatting terrorism internally, our vulnerability remains. In fact, while the losses from terrorist attacks are minimal compared to the 40,000 highway deaths or 18,000 murders that occur annually in this country, there is more at risk than the senseless loss of lives.

Terrorism is political theater designed to undermine or alter governmental authority or behavior. The apparent inability of established governments to respond effectively to incidents affects the confidence of citizens and allies alike. America's foes take comfort in the apparent weaknesses of our society that terrorism exposes.

Our vulnerability lies, ironically, in the strength of our open society and highly sophisticated infrastructure. Transportation, energy, communications, finance, industry, medicine, defense, diplomacy and government itself rely on intricate interrelated networks. Given these inherent vulnerabilities, and the fact that Americans are increasingly the targets of terrorist attacks outside the United States, it is apparent that a potentially serious domestic threat exists. Recent threats such as Qaddafi's statement that Libyans will attack "American citizens in their own streets" only serve to underscore this worsening climate.

# U.S. Policy and Response to Terrorists

Since no country is immune to terrorism, it is imperative that governments have the appropriate policies, intelligence and flexible response options to deal effectively with terrorist acts. Trained personnel and programs must be in place before, during and after each crisis, both to respond to the problem and to answer inevitable criticism in the event of failure. Long-term policies to achieve these objectives are costly, complicated and difficult, yet essential as a defense against the importation of terrorism from overseas.

## CURRENT POLICY

The U.S. position on terrorism is unequivocal: firm opposition to terrorism in all its forms and wherever it takes place. Several National Security Decision Directives as well as statements by the President and senior officials confirm this policy:

- The U.S. Government is opposed to domestic and international terrorism and is prepared to act in concert with other nations or unilaterally when necessary to prevent or respond to terrorist acts.

- The U.S. Government considers the practice of terrorism by any person or group a potential threat to its national security and will resist the use of terrorism by all legal means available

- States that practice terrorism or actively support it will not do so without consequence. If there is evidence that a state is mounting or intends to conduct an act of terrorism against this country, the United States will take measures to protect its citizens, property and interests.

- The U.S. Government will make no concessions to terrorists. It will not pay ransoms, release prisoners, change its policies or agree to other acts that might encourage additional terrorism. At the same time, the United States will use every available resource to gain the safe return of American citizens who are held hostage by terrorists.

- The United States will act in a strong manner against terrorists without surrendering basic freedoms or endangering democratic principles, and encourages other governments to take similar stands.

U.S. policy is based upon the conviction that to give in to terrorists' demands places even more Americans at risk. This no-concessions policy is the best way of ensuring the safety of the greatest number of people.

## EVOLUTION OF POLICY

U.S. policy on terrorism has evolved through years of experience in combatting terrorism and is an outgrowth of responses by various Administrations.

Following the terrorist attacks at the 1972 Munich Olympics, President Nixon established a Cabinet-level committee, chaired by the Secretary of State, to combat terrorism. Later during the Carter Administration this group was replaced with a more responsive program coordinated by the National Security Council. The program was designed to ensure interagency coordination and established the Lead Agency concept for managing terrorist incidents.

The Carter Administration also established a 10-member senior-level Interagency Executive Committee on Terrorism that eventually evolved into a group of more than 30 government organizations. The Committee was subsequently restructured along more functional lines.

During the first year of President Reagan's Administration, an organizational structure for crisis management was established with a group chaired by the Vice President and supported by appropriate interagency working groups.

In April 1982, the President refined specific Lead Agency responsibilities for coordination of the Federal response to terrorist incidents:

- Department of State—incidents that take place outside U.S. territory
- Department of Justice (FBI)—incidents that take place within U.S. territory
- Federal Aviation Administration (FAA)—incidents aboard aircraft that take place within the special jurisdiction of the United States.

In addition to the Lead Agency responsibilities, a number of interagency groups to facilitate coordination were established, including the Interdepartmental Group on Terrorism, to develop and coordinate overall U.S. policy on terrorism. Chaired by the Department of State, the group meets frequently to deal with issues such as international cooperation, research and development, legislation, public diplomacy, training programs and antiterrorist exercises.

The Antiterrorist Assistance Program was established in 1983 to provide counterterrorism training and law enforcement assistance to friendly foreign governments.

## RANGE OF RESPONSES TO TERRORISM

Terrorism requires a coordinated national response on three levels. First, the immediate problem of managing incidents must include measures taken before, during and after the event. Second, coping with the threat is a long-term task that involves protecting people and property, reducing threat levels, and influencing the users and sponsors of terrorism to desist. Finally, there is the challenge of identifying and alleviating the causes of terrorism.

### Managing Terrorist Incidents

While not applicable in every case, the options for managing terrorist incidents are:

- Preemption—Such actions are designed to keep an attack from occurring. Preemptive success is limited by the extent to which timely, accurate intelligence is available. Everyday activities that can preempt attacks include altering travel routes or avoiding routine schedules. Successful preemption of terrorist attacks is seldom publicized because of the sensitive intelligence that may be compromised.

- Delay—Sometimes avoiding specific reactions until the circumstances are favorable is the best course. Delaying tactics are used during a terrorist incident in order to stall for time to position forces, keep the terrorists off balance, or develop other responses. Such tactics are particularly valuable when time is important to secure international cooperation in order to apply economic, diplomatic, legal or military pressures.

- Third-Party Arrangements—When incidents occur overseas the host country has primary responsibility for managing the situation. In other cases, for diplomatic or political reasons, the use of third-parties may offer the best opportunity for successful resolution of the incident.

- Negotiating—The United States has a clear policy of no concessions to terrorists as the best way to protect the greatest number of people. However, the United States Government has always stated that it will talk to anyone and use every available resource to gain the release of Americans held hostage.

- Counterattacking or Force Options—Forceful resolution of a terrorist incident can be risky as evidenced by the recent episode involving the Egyptian airliner on Malta; careful planning and accurate, detailed intelligence are required to minimize risks.

Our principles of justice will not permit random retaliation against groups or countries. However, when perpetrators of terrorism can be identified and located, our policy is to act against terrorism without surrendering basic freedoms or endangering democratic values. We are prepared to act in concert with other nations, or unilaterally when necessary, to prevent or respond to terrorist acts. A successful deterrent strategy may require judicious employment of military force to resolve an incident.

Recent legislation has greatly expanded federal criminal jurisdiction over international terrorist incidents involving U.S. citizens. Violent terrorist acts are crimes. Accordingly, the United States will make every effort to investigate, apprehend and prosecute terrorists as criminals.

### Coping with the Threat

Dealing effectively with terrorism requires long-term measures for providing physical and personal security, training personnel, and enlisting the cooperation of other governments in protective measures, in gathering and sharing intelligence and in the elimination of terrorist threats.

The growth in frequency and violence of terrorist acts has increased physical and personal security costs, and changed lifestyles and work habits. Expenditures for security programs have grown sharply, but attacks against U.S. personnel and facilities in the Middle East, Europe and Latin America show that more must be done to provide security systems and to sensitize and train employees to better manage the threat.

Cooperation with host governments is essential, since they have the primary responsibility for providing security for U.S. citizens and facilities abroad. Their ability to monitor and control terrorist activities, as well as participate in cooperative measures to collect and share intelligence, is extremely important. Improving aviation and other international security programs and sharing benefits of terrorism-related research and development are equally critical. Securing cooperation in applying political or economic pressures on states that sponsor terrorism is a difficult yet vital part of the overall program.

### Alleviating Causes of Terrorism

Terrorism is motivated by a range of real and perceived injustices that span virtually every facet of human activity. The resulting grievances provide the basis for recruitment and the terrorists' justification of violence. A cooperative international effort to mitigate the sources of grievances, such as pursuing the peace process in the Middle East, is an essential yet complicated and long-term objective. The issues are complex, highly emotional and seldom amenable to outside solutions. However, efforts that promote democratic societies with guaranteed personal freedoms continue to be the cornerstone of U.S. foreign policy.

## U.S. RESOURCES FOR COMBATTING TERRORISM

Most resources committed to combatting terrorism are incorporated into a variety of diplomatic, military, legal and law enforcement programs. As a result, a precise identification of U.S. Government resources devoted to terrorism alone is difficult. At present more than 150 specific activities to combat terrorism are carried out by various federal departments and agencies.

Since 1970, federal expenditures to combat terrorism have increased severalfold. While it is extremely difficult to break out specific activities from those agencies that perform multiple functions, about $2 billion was spent in 1985 to combat terrorism both at home and abroad. The total number of people—calculated in terms of man-years—assigned to these various programs in 1985 was approximately 18,000.

The majority of the 150 activities included in this country's effort to combat terrorism fall within eight broad categories: research and development; administration and support; command, control and communications; intelligence; personnel security; physical security; counterterrorist operations; and education and training.

While agency estimates for funding and manpower needs for most of the categories are projected to continue at modest rates of growth through 1990, substantial increases in funding and manpower for physical security are expected at home and abroad.

Other program emphasis during this period is projected to occur in the following areas:

- More law enforcement, prosecution of terrorists
- Better security for civil aviation and maritime activities
- Increased assistance to other governments
- Better, more timely intelligence

Historically, security concerns have not received the high priority from government that they do today. Over the past few years, the dramatically changing situation has resulted in vastly increased financial and human resource expenditures to deal with the threat. By 1990, physical and personal security funding is expected to make up 40 percent of our resources committed to combatting terrorism.

## PERSONAL AND PHYSICAL SECURITY

Several federal and local government agencies are responsible for domestic protection of foreign missions, resident diplomats and visiting dignitaries. Although excellent relations exist, occasional coordination problems occur among agencies of the federal and local government. This affects reciprocal foreign government protection provided U.S. visitors, personnel and installations. Decisions to resolve the problems of overlapping jurisdictions are complicated and require comprehensive study.

Frequent and violent attacks overseas have become a major concern. Necessary reliance on host country protection of U.S. installations and personnel, the most visible and difficult to protect terrorist targets, complicates the security issue. U.S. efforts to minimize vulnerabilities, increase awareness, and provide maximum protection have, nonetheless, made progress.

For example, the Secretary of State's Advisory Panel on Overseas Security convened in 1984 with a mandate to consider the full range of issues related to improving the security of U.S. interests abroad and protecting foreign visitors at home. The recommendations, many already implemented, concern organizational structure, responsibility assignments, personnel systems, training, equipment, accountability and physical strengthening of facilities. The physical security program alone, which would modify existing structures and require some new buildings, is currently budgeted for $2.7 billion over the next five years.

## FEDERAL AGENCIES' ROLES IN COMBATTING TERRORISM

Most agencies' activities related to combatting terrorism are closely meshed with their other national security functions. To a large extent, their resources are also used for normal diplomatic initiatives, law enforcement, intelligence collection and analysis, research and development, and broad crisis management functions.

The National Security Council (NSC) advises the President on national security matters. Working closely with concerned interagency groups such as the Interdepartmental Group on Terrorism and the Crisis Pre-planning Group, it also coordinates the development and implementation of programs to combat terrorist attacks or threats. In the event of a terrorist incident, the NSC staff serves as liaison between the White House and the responsible Lead Agency.

As previously mentioned, three Lead Agency assignments are in place for managing terrorist incidents: the Department of State for incidents occurring outside the United States; the Department of Justice (FBI) for incidents within the United States; and the Federal Aviation Administration of the Department of Transportation for hijacked aircraft in flight.

Lead Agencies assume coordination responsibilities in addition to their statutory functions. The Lead Agency cannot exercise exclusive jurisdiction, but has the lead because of primary operational and policy responsibilities in the area concerned. It is expected to discharge its own functions and ensure that interests of other departments and agencies are reflected in recommendations to the National Security Council. Between incidents, the Lead Agency works with other agencies to develop policy approaches, maintain necessary relationships with other governments and organizations, keep current on intelligence and other developments in the field, and maintain a readiness to respond whenever an incident occurs. During an incident, the Lead Agency establishes and maintains a Working Group to coordinate with other agencies and to discharge its own primary responsibilities. Accordingly, State, the FBI and the FAA maintain operations centers with staff support, secure and nonsecure voice communications, and satellite capabilities worldwide.

The specific functions of each of the Lead Agencies, as well as those of other key federal departments, agencies and interagency working groups that are part of the national program are covered in detail in Appendix II.

## INTERNATIONAL COOPERATION

The national program to combat terrorism operates before, during and after an incident. Any strategy must include measures for deterrence, crisis management and response options. The first line of defense in every phase is international cooperation.

International cooperation offers the best hope for long-term success. More and more states recognize that unilateral programs for combatting terrorism are not sufficient. Without a viable, comprehensive, cooperative effort, terrorism and its supporters will benefit from the uncoordinated actions of its victims. International cooperation alone cannot eliminate terrorism, but it can complicate the terrorists' tasks, deter their efforts and save lives. In fact, numerous actual or planned attacks against U.S. or foreign targets have failed or were circumvented through multinational cooperation.

The United States pursues international cooperation through bilateral or multilateral agreements with like-minded nations and by serving as a member of various international organizations.

The United States has found the best multilateral forum for the discussion of terrorism to be the industrialized democracies which constitute the Summit Seven (United States, Canada, the United Kingdom, France, West Germany, Italy and Japan). This group has issued four joint declarations of unity (Bonn, 1978; Venice, 1980; Ottawa, 1981; and London, 1984), which have outlined areas of common concern. Additionally, the United States is looking for ways in which it can cooperate more closely with other countries outside this group. For example, there was strong emphasis in 1978 on anti-hijacking measures. The Bonn Declaration, signed in July 1978 by the United States, United Kingdom, Canada, France, Federal Republic of Germany, Italy and Japan, called for member countries to terminate civilian airline service to any country failing to prosecute or extradite a hijacker.

On December 9, 1985, the United Nations General Assembly, with strong U.S. support, passed by consensus vote its first unequivocal resolution condemning terrorism. Eleven days later the U.N. Security Council adopted a U.S.-initiated resolution condemning unequivocally all acts of hostage-taking and urging the further development of international cooperation among states to facilitate the prevention, prosecution and punishment of hostage-taking as international terrorism. While such resolutions lack implementing procedures and are thus largely symbolic, they are important to the development of a consensus among all nations that terrorism is unacceptable international behavior.

Another important international initiative is the State Department's Anti-Terrorism Assistance Program designed to enhance the ability of foreign governments to deal with the security and crisis management aspects of terrorism.

Substantial progress in international cooperation also has been made in the areas of aviation and maritime security. For example, in June 1985, following the hijacking of TWA Flight 847, the International Civil Aviation Organization (ICAO) moved quickly to upgrade its Standards and Recommended Practices for airport and aircraft security. The Departments of State and Transportation are seeking ways to take legal action against countries that do not maintain adequate airport security or refuse to extradite or prosecute hijackers. Procedures also are under consideration to provide international inspection teams to examine airport security arrangements worldwide.

In November 1985, following the hijacking of the *Achille Lauro*, the International Maritime Organization (IMO) acting on a U.S. initiative directed its Maritime Safety Committee to develop, on a priority basis, measures for the protection of passengers and crews aboard ships. Additionally, an interagency working group, chaired by the Department of Transportation, was established to assess worldwide port and shipping security. Its recommendations are being worked through the IMO, with bilateral and multilateral security initiatives being pursued as needed.

## CONSIDERATIONS IN DETERMINING RESPONSES

The United States can retaliate politically, economically and militarily. The utility of these actions depends in great measure on cooperation from other countries, but they can have a positive, long-range deterrent effect.

Use of our well-trained and capable military forces offers an excellent chance of success if a military option can be implemented. Such use also demonstrates U.S. resolve to support stated national policies. Military actions may serve to deter future terrorist acts and could also encourage other countries to take a harder line. Successful employment, however, depends on timely and refined intelligence and prompt positioning of forces. Counterterrorism missions are high-risk/high-gain operations which can have a severe negative impact on U.S. prestige if they fail.

A U.S. military show of force may intimidate the terrorists and their sponsors. It would not immediately risk more U.S. lives or prestige and could be more effective if utilized in concert with diplomatic, political or economic sanctions. There are, however, some distinct disadvantages: a show of force could be considered gunboat diplomacy, which might be perceived as a challenge rather than a credible threat; it may require a sizable deployment of support activities; it may provide our enemies with a subject for anti-American propaganda campaigns worldwide; and most important, an active military response may prove necessary to resolve the situation if a show of force fails.

Political or economic sanctions directed against sponsoring states offer the least direct danger to lives and property and are more likely than military force to gain international support. Such sanctions could stimulate domestic opposition to a government's support for terrorists, particularly if multinational in character. However, multilateral sanctions are difficult to organize and even then may not be effective. Further, they could unify the country against the United States, since sanctions often harm the general populace more than terrorists. In every case the advantages of sanctions must be weighed against other foreign policy objectives.

## INTELLIGENCE

Success in combatting terrorism is predicated on the availability of timely and accurate intelligence. One approach to assuring timely information in combatting terrorism involves conventional human and technical intelligence capabilities that penetrate terrorist groups and their support systems, including a sponsoring state's activities. An equally important approach is through investigative police efforts. Collecting tactical police intelligence aids in monitoring terrorists' activities and may be crucial to tracking subnational groups or small terrorist bands. The national intelligence effort relies heavily on collection and liaison arrangements that exist with many friendly governments. This effort must be augmented with the results of investigative police work and law enforcement liaison arrangements, which are currently being expanded.

Long-term intelligence programs to combat terrorism involve collection and analysis that address regional history, culture, religion, politics, psychology, security conditions, law enforcement and diplomatic relationships. The requirement for accurate analysis applies both to long-term threat assessments and to support incident management. All terrorism-related intelligence collection and analysis must be directed toward production and dissemination of clear, concise, and accurate threat warnings and assessments to decision-makers in time for them to take necessary action.

# The Role of Congress in Combatting Terrorism

Terrorism is a bipartisan issue and as the threat has increased, so has the resolve of Congress to ensure appropriate punishment of terrorists. In recent years, Congress and the Executive Branch have worked closely together to close existing statutory loopholes in our ability to prosecute terrorists and reduce their sources of support.

## CURRENT LEGISLATION

In 1984, several significant bills were passed that have enabled the United States to expand its jurisdiction over terrorists. These bills have greatly enhanced the U.S. role in prosecution of hijackers, making it a federal offense to commit an act of violence against any passenger on a government or civilian aircraft. The U.S. also now has the authority to prosecute any person who destroys a foreign aircraft outside of the United States if the terrorist is later found in this country.

Legislation covering crimes against the families of high-ranking federal officials provides for the prosecution of acts of violence against the immediate family members of the President, Vice President, Members of Congress, all federal judges, the heads of executive agencies, the Director of the CIA and federal law enforcement officials.

New 1984 "Murder-for-Hire" legislation makes it possible for the United States to prosecute anyone who travels or uses transportation or communications facilities in interstate or foreign commerce with the intent to murder for compensation.

The Attorney General and the Secretary of State received new authority from Congress in 1984 to reward any individual for information leading to the arrest and conviction of any person who committed terrorist acts against U.S. citizens or property. The Attorney General has delegated this authority to the Director of the FBI. The State Department currently has a $3 million budget to pay rewards in international terrorism cases.

Since January 1, 1985, the International Traffic in Arms Regulations have been expanded to require a license for anyone in the United States to train any foreign national (who is not a permanent resident alien of the United States) in the use, maintenance, repair or construction of any item included on a specified list of munitions.

## PENDING LEGISLATION

There are several significant initiatives in the Congress that are aimed at correcting many of the remaining statutory shortfalls. If passed, they could give the Administration greater capability in the legal battle against terrorism.

One of the major pieces of legislation that is under consideration is an amendment to the Hostage-Taking Act of 1984. This measure permits a death penalty if a terrorist takes the life of a person during a hostage-taking situation. The present maximum penalty is life imprisonment, even if a hostage is killed.

Another legislative measure would significantly expand federal criminal jurisdiction to allow prosecution of any terrorist who kills, seriously assaults, or kidnaps a U.S. citizen outside the United States, or conspires outside of the United States to murder an American citizen within the United States.

Recent decisions of U.S. courts have blocked the extradition of persons accused or convicted of terrorist acts abroad on the grounds that their violent crimes, including murder, were political offenses. Moreover, similar provisions in foreign extradition laws have frustrated efforts to bring accused terrorists to this country for trial. To correct this situation, the United States has begun negotiations with selected countries to revise extradition treaties to preclude the use of the political offense exception in cases involving violent crime.

Another pending initiative would permit nuclear reactor licensees access to FBI criminal history files. The review of these files could prevent hiring known or suspected criminals or terrorists to fill sensitive positions.

## POTENTIAL LEGISLATION

Two areas require review to determine whether legislation or other administrative measures are necessary. The first is airport and port security. Continuous review and upgrade of security measures are needed; however, no federal statutes currently mandate development of measures to protect ports, vessels, passengers or crew members.

The second is a review of the Freedom of Information Act (FOIA) to determine the validity of reported abuses. It is alleged that terrorists and terrorist organizations, in addition to unfriendly foreign governments, have used the Act to gain sensitive information. Should a review confirm such abuses, a revision will be required.

One area in which there is concern both in Congress and the Executive Branch is the issue of Congressional oversight of proposed counterterrorist operations. It may be appropriate to pursue informal discussions between the Congress and Executive Branch to clarify reporting and oversight requirements in this area. Because hostage rescue and counterterrorist operations are sensitive and involve a variety of different circumstances, no set of specific procedures would be appropriate in all cases.

Legislation calling for the formation of a Joint Committee on Intelligence has been introduced in the House, but is still in the early stages of development. The advantages are essentially twofold—streamlined procedures for intelligence oversight and reduced numbers of people who have access to sensitive information.

Finally, consideration should be given to legislation which gives the federal government primary jurisdiction over terrorist acts committed against federal officials and property as well as against foreign officials and facilities within the United States.

# Viewpoint of the American People

Terrorism deeply troubles the American people. A Roper Poll conducted before the TWA 847 hijacking showed that 78 percent of all Americans consider terrorism to be one of the most serious problems facing the U.S. Government today, along with the deficit, strategic arms control and unemployment.

Public sentiment about how to deal with terrorism also has political ramifications. The Iranian hostage situation demonstrated the political liabilities in failing to meet the expectations of American citizens. The standing of British Prime Minister Thatcher's government was enhanced in the aftermath of the 1980 rescue of the hostages at the Iranian Embassy in London. A Washington Post-ABC news poll showed that President Reagan received a large boost in standings from his success in dealing with the *Achille Lauro* hijacking—80 percent said they approved of the action. Frustration was also evident in the same poll with many Americans skeptical that apprehension of the hijackers would do much to alleviate terrorism.

Attacks on Americans in Beirut in 1983 and 1984 precipitated national grief and public frustration and resulted in significant changes in our foreign policy in the Middle East. The Americans currently held hostage in Lebanon continue to receive the concern of the American people and the highest priority of the U.S. Government.

A special group interview project, conducted in November 1985, helped to document the attitude of the American public. Individuals interviewed do not believe that terrorism has a direct effect on their lives, but the indirect effects evoked strong reactions. Americans feel fearful, vulnerable, victimized and angry. Most of all, they are frustrated by a sense of helplessness.

Also, the research project shows that Americans believe terrorism affects perception of the United States as a powerful country and world leader. Terrorism reduces America's status to being seen as a "pawn"—powerless, easily manipulated and at the mercy of attackers because Americans cannot or do not fight back.

The President is seen as ultimately responsible for fighting terrorism, although the group polled recognizes that government agencies are also involved. Most believe that the government is responsible for keeping them safe wherever they go.

Even though those Americans surveyed believe the government is virtually helpless when it comes to catching terrorists, they feel something should be done. Solutions recommended include international cooperation among countries, including economic sanctions, and tighter security at airports and aboard aircraft. Active measures such as military actions are much more controversial among those interviewed, although welcomed by many.

With regard to policy on terrorism, most responded that there was no cohesive policy, but said there should be one. There is an awareness that the United States will not negotiate with terrorists. Those interviewed believe a policy on terrorism should reflect national values: respect for individual life, respect for law, and respect for the sovereignty of nations.

Under the umbrella of such a policy, Americans would still welcome actions against terrorists that are swift, forceful and even aggressive. There is growing evidence the American people support timely, well-conceived, well-executed operations, such as the capture of the *Achille Lauro* hijackers. They endorse similar actions even if inadvertent casualties result.

Also, those surveyed think Americans need to be made aware and reassured that U.S. counterterrorist forces are highly trained and capable.

# Terrorism and the Media

Terrorism is a form of propaganda, demanding publicity to be effective. Among the factors cited for the increases in both the number and sensational nature of incidents is the terrorists' success in achieving wider publicity and influencing a much broader audience. Terrorists see the media's role in conveying their messages worldwide as essential to achieving their goals. If the violence is spectacular, wide coverage is usually assured.

Terrorist acts are newsworthy, and the media see coverage as a professional, competitive responsibility. Some in the media have claimed that intense coverage helps to resolve an incident and that putting the hostages on television may actually save their lives. The other side of this argument is that untimely or inaccurate information released by the media can interfere with resolution of an incident, foreclose options for dealing with it, or unwittingly provide intelligence information to terrorists, which prolongs an incident or endangers lives.

It is essential, therefore, that the government and the media cooperate during a terrorist incident, which almost inevitably involves risk to human lives, human rights and national interests.

One difficulty for the press is that it cannot provide accurate coverage that takes into account risk to government action unless it has some accurate sense of what the government is attempting. Government thus can assist by providing as much timely, factual information as the situation allows.

Media practices that can lead to problems during an incident are:

- Saturation television coverage, which can limit or preempt the government's options.
- Political dialogue with terrorists or hostages.
- Coverage of obviously staged events.
- Becoming part of the incident and participating in negotiations. The media in the role of an arbiter usurps the legal responsibilities of the government.
- Payments to terrorist groups or supporters for interviews or access.
- Coverage of military plans or deployments in response to terrorist incidents.

The solution to these problems is not government-imposed restraint that conflicts with the First Amendment's protection of freedom of speech and the press. The media must serve as their own watchdog. Journalistic guidelines have been developed for use during wartime to protect lives and national security, and in some circumstances should be considered appropriate during a terrorist situation.

The government has a responsibility to maintain effective communications during a terrorist incident. Officials should keep their comments within cleared guidance, avoid sending inadvertent signals, or leading other governments astray. Conflicting statements by different departmental spokespersons give an impression of disarray, which meets one of terrorism's objectives.

Many Americans believe that terrorists use the media to achieve their goals, according to the previously mentioned research study. While they also believe that the media exaggerates and sensationalizes incidents, they firmly support absolute freedom of the press as guaranteed by the First Amendment.

Television coverage received the most criticism, with some coverage perceived as inaccurate, incomplete and not reflective or analytical. According to those interviewed, it has the potential for making heroes out of criminals and exploiting the privacy and grief of affected families. Television also dramatizes the entertainment value of an event. Newspapers were judged as offering more detailed information and news magazines as offering more perspective.

The Task Force found that much of the media coverage concentrates on the families of hostages as human interest stories. Their public statements understandably reflect the perspectives of distraught individuals principally concerned with the safe return of their relatives. Some of these statements may unintentionally play into the hands of terrorists, who reinforce the families' concerns by claiming the lives of the hostages are in danger. Family members sometimes turn to the media to bring pressure on the Administration to take action that may not be appropriate or possible.

While both the American public and the Administration have debated the role of the media in terrorist incidents, the media has questioned its own policies. The coverage of the TWA Flight 847 hijacking in June 1985, where 104 Americans were taken hostage and one was murdered, stimulated a professional review within the media to reexamine the balance between the desired goal of keeping the people informed and the vital issue of public security. Individual media organizations have discussed professional reporting guidelines, and ethical standards have been adopted by some members of the press, including television networks. However, there is no industry consensus on either the need for or the substance of such guidelines.

# Task Force Conclusions and Recommendations

Terrorists of the '80s have machine-gunned their way through airports, bombed U.S. Embassies and military facilities, pirated airplanes and ships, and tortured and murdered hostages as if "performing" on a global theater screen. These international criminals have seized not only innocent victims but also the attention of viewers who sit helplessly before televisions around the world.

International terrorism is clearly a growing problem and priority, requiring expanded cooperation with other countries to combat it. Emphasis must be placed on increased intelligence gathering, processing and sharing, improved physical security arrangements, more effective civil aviation and maritime security, and the ratification and enforcement of treaties.

It is equally essential, however, that our defense against terrorism be enhanced domestically. For unless the trend of terrorism around the world is broken, there is great potential for increased attacks in our own backyard.

The Task Force's review of the current national program to combat terrorism found our interagency system and the Lead Agency concept for dealing with incidents to be soundly conceived. However, the system can be substantially enhanced through improved coordination and increased emphasis in such areas as intelligence gathering, communications procedures, law enforcement efforts, response option plans, and personal and physical security.

Terrorism is a bipartisan issue and one that members of Congress have jointly and judiciously addressed in recent years. Significant bills have been passed that markedly expand U.S. jurisdiction over terrorists and close prosecution loopholes.

However, there are stronger legislative proposals that are now before Congress that would further strengthen the nation's ability to combat terrorism both at home and abroad. Many of these proposals merit strong Administration support. It is also essential that the Executive Branch agencies continue to work closely with Congress in reviewing our current programs and recommending other legislative initiatives as appropriate.

Terrorism deeply troubles the American people. They feel angry, victimized, vulnerable and helpless. At the same time, they clearly want the United States Government to have a strong and consistent national antiterrorist policy. While such a policy exists, the Task Force believes that better communication is necessary to educate the public to our policy and to the ramifications of using force during a terrorist attack.

Americans also believe that terrorists take advantage of our free press to achieve their goals. News coverage of terrorism has created a dilemma for media executives: how to keep the people informed without compromising public security. Solving this problem will have to be a joint effort between media and government representatives. The government must improve its communications with the media during a terrorist attack. At the same time, the media must maintain high standards of reporting to ensure that the lives of innocent victims and national security are not jeopardized.

In December 1985, the Task Force on Combatting Terrorism completed its comprehensive examination of terrorism both internationally and domestically. It also finished its review of our nation's policy and programs for combatting terrorism.

The resultant findings emphasized the importance and appropriateness of a no-concessions position when dealing with terrorists. Some of the recommendations must remain classified, but the following unclassified Task Force recommendations are in keeping with that national policy and are intended to strengthen and streamline our current response system.

## NATIONAL POLICY AND PROGRAM RECOMMENDATIONS

### National Programming Document

Currently a number of agencies and departments within the Executive Branch are responsible for the elements of our national program to combat terrorism. While this is a reasonable and appropriate approach, the various elements should be compiled in a single programming document. Such a comprehensive listing would allow quick identification of agencies responsible for dealing with particular aspects of terrorism and their available resources.

The Task Force believes that such a document is necessary for the most effective coordination of the department and agency activities that comprise our national program. The NSC staff, in conjunction with OMB and the Departments of State and Justice, would maintain this national programming document.

### Policy Criteria for Response to Terrorists

Because acts of terrorism vary so much in time, location, jurisdiction and motivation, consistent response is virtually impossible. However, the Interdepartmental Group on Terrorism should prepare, and submit to the NSC for approval, policy criteria for deciding when, if and how to use force to preempt, react and retaliate. This framework will offer decisionmaking bodies a workable set of standards by which to judge each terrorist threat or incident. The use of this framework also would reassure the American people that government response is formulated consistently.

Criteria for developing response options might include the following:

- Potential for injury to innocent victims
- Adequacy and reliability of intelligence
- Status of forces for preemption, reaction or retaliation
- Ability to identify the target
- Host country and international cooperation or opposition
- Risk and probability of success analysis

- U.S. public attitude and media reaction
- Conformance with national policy and objectives

### Establish New National Security Council Position

A full-time NSC position with support staff is necessary to strengthen coordination of our national program. Working closely with the designated Lead Agencies, the position will be responsible for:

- participating in all interagency groups
- maintaining the national programming document
- assisting in coordinating research and development
- facilitating development of response options
- overseeing implementation of the Task Force recommendations

### Speak with One Voice

Clear communications by appointed spokespersons and coordination of public statements during a terrorist incident are vital. Interagency working groups should provide specific guidance to all spokespersons on coordinating public statements. Without coordination, inaccurate information may result, intelligence resources may be compromised and political distress can result among friends and allies throughout the world—at a time when international cooperation can save lives.

Designation of spokespersons and response guidelines are especially important given the intense media pressure for comment during terrorist incidents. A misstatement or failure to consider legal issues before commenting to news media could jeopardize a criminal investigation or an eventual prosecution.

### Review American Personnel Requirements in High-Threat Areas

Actions already have been taken to strengthen security of U.S. installations and to reduce personnel in dangerous areas. However, to date these efforts have not been fully coordinated among all agencies. The Department of State should direct Ambassadors in all designated high-threat areas to thoroughly review personnel requirements to determine if further personnel reductions are possible at U.S. facilities overseas. This review should include careful consideration of physical vulnerability of embassy-related facilities. The Department of Defense also should conduct a similar review for military commands abroad.

## INTERNATIONAL COOPERATION RECOMMENDATIONS

### Pursue Additional International Agreements

International cooperation is crucial to long-term deterrence of terrorism. It can be achieved through multilateral and bilateral agreements. While progress in achieving a multilateral agreement has been slow, efforts should continue to reach an agreement to show that many nations are committed to fighting terrorism as an international crime against society.

In the absence of a multilateral agreement, the Department of State should aggressively continue to seek international cooperation through:

- general resolutions or agreements, in the United Nations and in other specialized organizations, concerning civil aviation, maritime affairs and tourism
- enhanced and more widely-ratified international conventions on subjects such as hijacking, hostage-taking and protection of diplomats
- less formal agreements that illustrate an international consensus to take effective action against terrorism
- improved implementation of existing agreements to fight terrorism

### Close Extradition Loopholes

The United States itself is sometimes used as a safehaven for terrorists. Present extradition treaties with other countries preclude the turning over of fugitives wanted for "political offenses," an obvious loophole for terrorists. The State Department should seek extradition treaty revisions with countries with democratic and fair judicial systems to ensure that terrorists are extradited to the country with legal jurisdiction.

The process of closing these loopholes has begun with the United Kingdom in the form of proposed revisions to the US/UK Supplementary Treaty. The State Department should vigorously pursue Senate approval of this treaty and continue the revision process with other countries to ensure that terrorists are brought to justice.

### Impose Sanctions Against Vienna Convention Violators

It is a fact that certain governments actively support terrorism. These states sometimes use their diplomatic missions as safehavens for terrorists or as caches for their materiel—a direct violation of the Vienna Convention. The State Department should continue working with other governments to prevent and expose violations of the Vienna Convention. A U.N. General Assembly resolution condemning the protection of terrorists in diplomatic missions could complement U.S. efforts to counter this abuse.

### Evaluate and Strengthen Airport and Port Security

Pre-flight screening of passengers and carry-on baggage is a cornerstone of our domestic security program. Since 1972 these procedures have detected over 30,000 firearms and resulted in 13,000 arrests. However, the recent terrorist acts against international aviation and maritime interests indicate a need for continual monitoring and updated security procedures. This is especially true at ports and on board ships where there are no international or federally prescribed security measures.

The interagency Working Group on Maritime Security, chaired by the Department of Transportation, should survey security procedures and the threat potential to vessels, passengers and crew members. It also should review statutory authority. If adequate authority does not exist, recommendations should be made, in consultation with other appropriate agencies, for new legislation. In addition, legislation should be pursued to allow for a criminal background investigation of individuals working in restricted areas at airports and terminals. Finally, the Department of State and the Coast Guard should continue to work through the International Maritime Organization to develop internationally agreed measures to protect ships' passengers and crews.

## INTELLIGENCE RECOMMENDATIONS

### Establish a Consolidated Intelligence Center on Terrorism

Intelligence gathering, analysis and dissemination play a pivotal role in combatting terrorism. Currently, while several federal departments and agencies process intelligence within their own facilities, there is no consolidated center that collects and analyzes all-source information from those agencies participating in antiterrorist activities. The addition of such a central facility would improve our capability to understand and anticipate future terrorist threats, support national crisis management and provide a common database readily accessible to individual agencies. Potentially, this center could be the focus for developing a cadre of interagency intelligence analysts specializing in the subject of terrorism.

### Increased Collection of Human Intelligence

U.S. intelligence gathered by technical means is adequate and pursued appropriately. At the same time, there is clear need for certain information that can only be gained by individuals. An increase in human intelligence gathering is essential to penetrate terrorist groups and their support systems.

### Exchange of Intelligence between Governments

The national intelligence effort relies heavily on collection and liaison arrangements that exist with many friendly governments. Such exchanges with like-minded nations and international law enforcement organizations have been highly useful and should be expanded to support our own intelligence efforts.

## LEGISLATIVE RECOMMENDATIONS

### Make Murder of U.S. Citizens Outside the Country a Federal Crime

Currently, it is not a crime under U.S. law to murder an American citizen outside our borders—with the exception of diplomats and some government officials. Legal protection of diplomats should be extended to include all U.S. nationals who are victims of international terrorism. The Departments of State and Justice should continue urging Congress to adopt legislation, such as the Terrorist Prosecution Act of 1985, that would accomplish this objective.

### Establish the Death Penalty for Hostage Murders

While there is legislation that allows the imposition of the death penalty if a death results from the seizure of an aircraft, there is no specific legislation that would allow for the same penalty for murder of hostages in other situations. The Justice Department should pursue legislation making anyone found guilty of murdering a hostage under any circumstances subject to the death penalty.

### Form a Joint Committee on Intelligence

Procedures that the Executive Branch must follow to keep the Select Intelligence Committees informed of intelligence activities need streamlining. Adoption of a Joint Resolution introduced last year by Congressman Hyde would create a Joint Committee on Intelligence. This Resolution would reduce the number of people with access to sensitive information and provide a single secure repository for classified material. The Department of Justice should lead an Administration effort to secure passage of the Hyde proposal.

### Establish Additional Incentives for Terrorist Information

The 1984 Act to Combat International Terrorism authorizes payment of up to $500,000 for information in cases of domestic and international terrorism. Many feel this legislation does not go far enough.

The State Department should lead an interdepartmental push with Justice and CIA for legislation to develop a unilateral and/or bilateral program to encourage individuals to provide information about terrorists' identity or location. In addition to monetary rewards, other incentives include immunity from prosecution for previous offenses and U.S. citizenship for the individual and immediate family.

Authorized rewards should be publicized to both foreign and American audiences and consideration should be given to raising the current $500,000 ceiling to $1 million.

### Prohibit Mercenary Training Camps

The International Trafficking in Arms Regulations have been strengthened to require a license to train foreign persons in the use of certain firearms; however, mercenary/survival training camps still operate domestically within the law. Appropriate agencies should closely monitor the extent to which foreign nationals are being trained in the United States in the use of firearms and explosives and seek additional legislation if necessary.

### Stop Terrorist Abuse of the Freedom of Information Act

Members of terrorist groups may have used the Freedom of Information Act to identify FBI informants, frustrate FBI investigations and tie up government resources in responding to requests. This would be a clear abuse of the Act that should be investigated by the Department of Justice and, if confirmed, addressed through legislation to close the loophole.

### Study the Relationship between Terrorism and the Domestic and International Legal System

International and domestic legal systems are adequate to deal with conventional war and crime. However, on occasion, questions of jurisdiction and authority arise when it comes to terrorism. For example, there are ambiguities concerning the circumstances under which military force is appropriate in dealing with terrorism. This lack of clarity about the international law enforcement relationships and legal systems could limit governments' power to act quickly and forcefully. The Departments of State and Justice should encourage private and academic study to determine how international law might be used to hasten—rather than hamper—efforts to respond to an act of terrorism.

### Determine if Certain Private Sector Activities Are Illegal

In some cases individuals and companies have paid ransoms to terrorists for the return of kidnapped employees or stolen property. Such action is in direct conflict with the national policy against making concessions or paying ransoms to terrorists. The Department of Justice should consider whether legislation could be enacted and enforced to make such payments to terrorist organizations illegal.

## COMMUNICATIONS RECOMMENDATIONS

### Expand our Current Support Program for Hostage Families

Due to the intense pressure of a hostage situation, some family members of hostages have pressured the highest levels of government for information. While this is understandable, such activity has the potential to delay return of hostages by giving terrorists the media attention they seek or the belief that their demands are being considered. Further, the inadvertent disclosure of sensitive information could jeopardize efforts to gain the release of hostages.

The family liaison program, conducted by State's Bureau of Consular Affairs, should provide a broader outreach program to include visits, hot-lines, information on private counseling services and a personal contact for each family for communication even when there is nothing new to report. Such an expanded contact program will help the families understand that the hostages' interests are being given the highest priority by our government.

### Launch a Public Education Effort

Because of the lack of understanding and currently available information concerning our national program for combatting terrorism, a broad education effort should be undertaken to inform the American public about our policy and proposals as well as the many ramifications of the use of force against terrorism, including death of innocent people, destruction of property, alienation of allies and possible terrorist reprisals. The education effort would take the form of publications, such as this report, seminars and speaking opportunities by government officials.

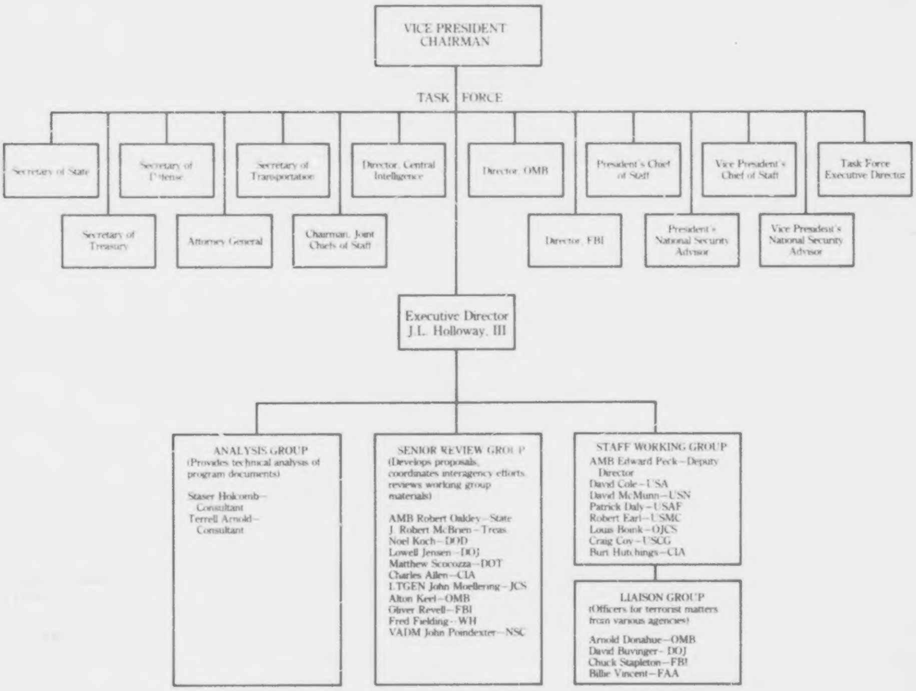
### Working with the Media

Terrorists deliberately manufacture sensations to capture maximum media attention—a ploy that often takes advantage of U.S. press freedom. This activity can be offset by close communication between media and government. The U.S. Government should provide the media with timely information during a terrorist crisis. The media, in turn, should ensure that their reporting meets the highest professional and ethical standards.

Regular meetings between media and government officials on the coverage of terrorism could contribute to more effective government-media relations.

# Appendix I

## VICE PRESIDENT'S TASK FORCE ON COMBATTING TERRORISM


VICE PRESIDENT
CHAIRMAN
TASK FORCE
Secretary of State
Secretary of Defense
Secretary of Transportation
Director, Central Intelligence
Director, OMB
President's Chief of Staff
Vice President's Chief of Staff
Task Force Executive Director
Secretary of Treasury
Attorney General
Chairman, Joint Chiefs of Staff
Director, FBI
President's National Security Advisor
Vice President's National Security Advisor
Executive Director
J.L. Holloway, III
ANALYSIS GROUP
(Provides technical analysis of program documents)
Staser Holcomb—Consultant
Terrell Arnold—Consultant
SENIOR REVIEW GROUP
(Develops proposals, coordinates interagency efforts, reviews working group materials)
AMB Robert Oakley—State
J. Robert McBrien—Treas
Noel Koch—DOD
Lowell Jensen—DOJ
Matthew Scocozza—DOT
Charles Allen—CIA
LTGEN John Moellering—JCS
Alton Keel—OMB
Oliver Revell—FBI
Fred Fielding—WH
VADM John Poindexter—NSC
STAFF WORKING GROUP
AMB Edward Peck—Deputy Director
David Cole—USA
David McMunn—USN
Patrick Daly—USAF
Robert Earl—USMC
Louis Boink—OJCS
Craig Coy—USCG
Burt Hutchings—CIA
LIAISON GROUP
(Officers for terrorist matters from various agencies)
Arnold Donahue—OMB
David Buvinger—DOJ
Chuck Stapleton—FBI
Billie Vincent—FAA

# Appendix II

## RESPONSIBILITIES OF PRINCIPAL DEPARTMENTS AND AGENCIES

Numerous federal departments and agencies contribute to the national program to combat terrorism. The following provides a detailed listing of the various activities of those agencies with major responsibilities.

The Department of State carries out programs for combatting terrorism in the following ways:

- Discharges its Lead Agency responsibilities for terrorism outside the United States
- Maintains the security of U.S. overseas diplomatic and consular facilities
- Cooperates with U.S. businesses as part of its effort to enhance the security of private U.S. citizens abroad
- Conducts research and analysis on terrorism
- Provides security for visiting foreign diplomats and dignitaries
- Protects the Secretary of State
- Provides training for personnel of U.S. overseas missions on security and crisis management
- Provides antiterrorism training and assistance to civilian security forces of friendly governments.

The principal offices involved in these functions are the Office of the Ambassador-at-Large for Counter-Terrorism; the newly created Bureau of Diplomatic Security; the Bureau of Intelligence and Research; the Office of Foreign Building Operations; the Foreign Service Institute; and the Office of Foreign Missions.

### Department of Justice

The Department of Justice pursues the following counterterrorism-related activities and programs through the FBI, the Justice Department's Criminal Division and the Immigration and Naturalization Service:

- Carries out its Lead Agency function to prevent, respond to, and investigate violent criminal activities of international and domestic terrorist groups within U.S. jurisdiction
- Investigates terrorist acts abroad under the new Hostage-Taking Statute that makes the hostage-taking of U.S. citizens overseas a federal crime
- Collects and investigates intelligence on terrorists to predict potential movement or criminal activities

- Investigates terrorist incidents and related criminal activities using investigative techniques to identify, arrest, prosecute, and incarcerate those responsible
- Maintains operational liaison with local law enforcement agencies throughout the United States
- Provides training in the field and at the FBI Academy, Quantico, Virginia
- Participates with local and state authorities in joint terrorism task forces
- Provides computer-assisted research and analytical capability to other law enforcement and intelligence community agencies involved with counterterrorism
- Maintains contact with and conducts limited joint investigations with allied national police and security services on terrorism through 13 legal attache offices
- Collects technical information regarding terrorist explosives and bombings within the United States and disseminates it to international bomb data centers
- Heads the national Hostage Rescue Team, a special group of highly trained FBI agents who deal with critical terrorist situations.
- Provides legal direction and support during terrorism investigations
- Supervises and coordinates subsequent prosecution of members of domestic and international terrorist groups whose acts violate federal criminal law
- Inspects and determines eligibility for applicants to enter the United States
- Maintains national and local lookout systems containing data relating to excludable aliens, including suspect or known terrorists.

### Department of Transportation

The Department of Transportation's Federal Aviation Administration, U.S. Coast Guard and the Office of the Secretary conduct antiterrorism programs by carrying out the following:

- Conducts Lead Agency responsibilities through the Federal Aviation Administration by promoting the security of civil aviation, including prevention of air piracy, sabotage and criminal activities within the jurisdiction of the United States
- Provides assistance to law enforcement agencies in interdicting movements into the United States of dangerous drugs and narcotics that may be connected with terrorist activities
- Maintains operational, investigative, communications, and liaison arrangements, with many foreign governments and private organizations such as aircraft manufacturers and airline pilots' associations

- Devotes substantial resources to airport and aircraft security programs both inside the United States and abroad

- Assures the safety and security of vessels, ports, and waterways, and their related shore facilities

- Offers transportation safety courses at domestic facilities in support of the Department of State's Anti-Terrorism Assistance Program

- Advises on transportation security matters; provides security programs to protect personnel, communications equipment, and facilities

## Department of Defense

Defense Department agencies involved in combatting terrorism include the National Security Agency, the Defense Intelligence Agency and the Joint Chiefs of Staff. Individual armed services antiterrorist programs supplement the overall Defense Department effort. After the Iranian hostage rescue attempt, the Department of Defense established a counterterrorist organization with permanent staff and specialized forces. These forces, which report to the National Command Authorities through the Joint Chiefs of Staff, provide a range of response options designed to counter specific acts of terrorism.

Additionally, the Defense Department maintains worldwide technical collection systems for gathering round-the-clock information on terrorism, which it disseminates to other federal agencies. It also contributes intelligence analysis and operational support to the national counterterrorism effort, maintains data on terrorist groups and produces publications on incidents and advisory and warning messages.

## Central Intelligence Agency

The Central Intelligence Agency and other elements of the intelligence community contribute vitally important intelligence to the NSC and the Lead Agencies before, during and after terrorist incidents. This organization is particularly crucial in the flow of information between the United States and other countries.

Analytical units of the CIA prepare both current and long-term reports on terrorist organizations, individuals and trends, and disseminate these reports on a timely basis to all government agencies with counterterrorist responsibilities. Should the White House direct military action in a counterterrorist situation, the CIA is prepared to provide intelligence support to the Defense Department.

The Director of Central Intelligence has overall coordinating responsibility within the intelligence community for counterterrorism. He has designated the National Intelligence Officer for Counterterrorism as the focal point to coordinate national counterterrorism intelligence activities and to ensure counterterrorism priorities are established for the intelligence community.

## Department of the Treasury

Treasury's role in the fight against terrorism involves protection, investigation, intelligence, interdiction, training and response. Its activities range from thwarting an assault on the President, to investigating an arms export case, to imposing and enforcing economic sanctions on state sponsors of terrorism.

Principal Treasury agencies are the United States Secret Service, the Bureau of Alcohol, Tobacco, and Firearms, the United States Customs Service, the Federal Law Enforcement Training Center and the Internal Revenue Service.

## Interagency Programs

Numerous interagency bodies contribute significantly to the national program. The major coordination effort, however, is carried out by the Interdepartmental Group on Terrorism, which is chaired by the Department of State and comprised of representatives from over a dozen departments and agencies.

Specific working groups have been established under the auspices of the Interdepartmental Group on Terrorism. Some of the more noteworthy are:

- Technical Support Working Group—assures the development of appropriate counterterrorism technological efforts
- Public Diplomacy Working Group—designed to generate greater global understanding of the threat of terrorism and efforts to resist it
- Anti-terrorist Assistance Coordinating Committee—coordinates the antiterrorism training programs of State, Defense and the CIA
- Rewards Committee—develops procedures for the monetary rewards program for information on terrorists
- Exercise Committee—coordinates antiterrorism exercise programs
- Maritime Security Working Group—assesses port and shipping vulnerabilities to terrorism
- Legislative Group—reviews legislative proposals and develops future antiterrorist initiatives.

Mr. McHugh. Thank your very much, Mr. Ambassador.

Mr. McHugh. I see our chairman has now arrived.

[Clerk's note.—The remainder of the hearing was held in executive session and has been retained by the Committee. The motion to hold an Executive Session was taken during the morning hearing of March 6th.]

WEDNESDAY, MARCH 12, 1986.

## EAST ASIA REGIONAL HEARING

### WITNESSES

JOHN C. MONJO, PRINCIPAL DEPUTY ASSISTANT SECRETARY, BUREAU OF EAST ASIAN AND PACIFIC AFFAIRS

CHARLES W. GREENLEAF, JR., ASSISTANT ADMINISTRATOR, BUREAU FOR ASIA AND NEAR EAST

JAMES KELLY, DEPUTY ASSISTANT SECRETARY, EAST ASIA AND PACIFIC AFFAIRS

### FY '87 REQUEST FOR EAST ASIA AND THE PACIFIC

Mr. OBEY. Good morning. Let me apologize for being late. We had a surprise democratic caucus on the budget for the coming year. So I thought we ought to be over there to defend our interests for the moment.

This morning the Committee will hear from Administration witnesses concerning the fiscal 1986 request for $729 million in funds for the East Asia region. Funding in this area is proposed to be increased by $145 million, 25 percent above existing levels for fiscal '86. I think I said fiscal '86 budget request. I mean fiscal '87.

Obviously of primary importance to the Committee would be developments which have taken place in the Philippines and how the Administration's request relates to those. In that sense we are sort of in a difficult position, because I suppose that much of the information which you can provide will be a little spongy until Mr. McPherson and others get back.

Nevertheless, we are trying to finish our hearings within two weeks so we can mark up a bill immediately thereafter. I will nonetheless be interested in any information you can provide.

Additionally, the Committee will explore the Administration's request for assistance in Cambodia, Indonesia, Thailand, and Korea.

We have with us this morning Mr. John Monjo, Principal Deputy Assistant Secretary, Bureau of East Asian and Pacific Affairs, Department of State; Mr. Charles Greenleaf, Assistant Administrator, Bureau for Asia and Near East, Agency for International Development; and Mr. James Kelly, Deputy Assistant Secretary, East Asia and Pacific Affairs, Department of Defense.

Gentlemen, why do you not proceed to make whatever remarks you care to make.

Mr. MONJO. Mr. Chairman, members, I appreciate very much this opportunity to present our fiscal year 1987 foreign assistance proposal for East Asia and the Pacific. I will present a brief summary and then ask that the full presentation be entered into the record, sir.

Mr. OBEY. Sure.

Mr. MONJO. U.S. interests are well served by the economic and military assistance we have given our allies and friends in Asia. By in large the developing countries in Asia have healthier economies and are moving forward faster than any other area in the world. While this is due in large part to their own efforts, our assistance has been an important catalyst.

We feel the security we have contributed is important to the stability of the region, maintenance of peace in the Korean peninsula and to the ability of Thailand to resist Vietnamese incursions on its border with Cambodia. The Philippines faces a domestic Communist insurgency, and deserves our continuing attention.

Our foreign assistance programs are a key element in our policy of the region which today faces a new and active Soviet diplomatic offensive. Soviet Foreign Minister Shevardnadze's visit to Japan symbolizes this renewed activity, which has also seen trips to Southeast Asia and the Pacific by other Soviet dignitaries,

Furthermore, the Soviet military buildup in the region is undiminished as are Moscow's ties with the Vietnamese and North Korean regimes.

At the same time the nations of the region are facing increasingly serious economic challenges. In addition to the economic problems of the Philippines, with which we are all familiar and I am sure will be discussing at some length this morning, other nations in the region face major difficulties'

Indonesia, which depends on oil for about 80 percent of export revenues and 20 percent of economic output faces problems with the worldwide decline in oil prices. The government has adopted an austerity budget with average cuts of about 22 percent across the board.

Malaysia, which has a good economy basically, expects the worst downturn in over a decade. Thailand's friendly and helpful government is having trade problems and its debt service burden is now very heavy.

Overall our proposed assistance requests are in line with prior year programs and the 1986 request. Increases above the 1986 appropriation represent overall a desire and attempt to keep our programs at approximately previous requested levels. Our assistance programs concentrate on the region's more threatened or vunerable nations, the Philippines, the Republic of Korea, and Thailand.

The assistance program for the Philippines was prepared before the recent events, and we are carefully reviewing the elements of our future program.

The Chairman has mentioned Mr. McPherson's trip to the Philippines. I would note that he is accompanied by the Deputy Head of DSA from Defense, a man from Treasury, and by other State Department officials. It is an important team, and we look forward to the results of their discussions out there.

In Korea, tensions remain high despite the beginnings of a welcome dialogue between North Korea and Seoul. The threat of North Korean aggression remains serious and immediate. We as an ally must remain especially vigilant during the Seoul Olympics, which the north Koreans have bitterly opposed.

Because the Republic of Korea is devoting a large portion of its GNP to defend itself, continued FMS credits are needed if Korea is to meet the key objectives of the force improvements plan.

Thailand needs our assistance to achieve development goals to maintain a healthy economy in the face of economic problems and effectively carry its share of our mutual security burden. Like Korea, Thailand must devote substantial resources to badly needed military modernization and creation of a deterent to Vietnamese agression.

The Soviet challenge dramatizes again the importance of the ASEAN nations which sit astride the vital sealanes joining Asia with the Middle East and Europe. The United States and the free world have a critical interest in this important part of the world. Our security assistance programs to Malaysia is a very small part, and those in Singapore and in Indonesia help ensure the stability of this region.

Finally, in the Pacific itself, we see the most active Soviet interest in an area of strategic importance to the United States. The regional fisheries agreement we are negotiating as well as our continuing small assistance programs with the island nations are a small price to pay for our interests in the area.

As you can see, our programs in East Asia and the Pacific, which make up only a modest portion of our worldwide foreign assistance request for FY-87, are an important part of our policy in this key area of U.S. interest.

Mr. Chairman, we believe in the current austere budget environment, our programs for East Asia and the Pacific represent a lean and realistic approach to meeting U.S. needs in that vital region.

Thank you, sir.

[Statement follows:]

# DEPARTMENT OF STATE

# FY 1987 FOREIGN ASSISTANCE REQUEST

STATEMENT OF

JOHN C. MONJO

ACTING ASSISTANT SECRETARY OF STATE

BUREAU OF EAST ASIA AND PACIFIC AFFAIRS

BEFORE

THE SUBCOMMITTEE ON FOREIGN OPERATIONS

OF THE

HOUSE APPROPRIATIONS COMMITTEE

MARCH 12, 1986

Mr. Chairman and Members of the Committee:

I appreciate this opportunity to present our fiscal year 1987 foreign assistance proposal for East Asia and the Pacific.

US interests are well served by the economic and military assistance we have given our allies and friends in Asia. By and large the developing countries in Asia have healthier economies and are moving forward faster than in any other area of the world. While this is due in large part to their own efforts, our assistance has been an important catalyst. In the field of security, we have contributed importantly to the stability of the Korean peninsula and to the ability of Thailand to resist Vietnamese incursions on its border wih Cambodia. The Philippines faces a domestic communist insurgency and I will be addressing this question.

Our foreign assistance programs are a key element in our policy in the region which today faces a new and active Soviet diplomatic offensive. Soviet Foreign Minister Shevardnadze's visit to Japan symbolizes this renewed activity which also witnessed a trip by a Deputy Premier to Southeast Asia and commercial offers in Southeast Asia and the Pacific. Moreover, the Soviet military buildup in the region is undiminished as are Moscow's ties to the aggressive SRV and DPRK regimes.

At the same time, the nations of the region are facing increasingly serious economic challenges. In addition to the economic problems of the Philippines with which we are all familiar, other nations in the region face major difficulties. Indonesia which depends on oil for 80% of its export revenues and 20% of its economic output faces the same economic problems as other high-population, low-income oil exporting nations. Given these problems, the government has adopted an austerity budget with average cuts of 22 per cent for each Department. Malaysia also anticipates the worst downturn in its commodity-export based economy in over a decade. Thailand's friendly and helpful government is having trade problems and its debt service burden is now very heavy. These economic difficulties offer new opportunities for the Soviet diplomatic offensive and underline the need for strong economic and security assistance programs to support our interests.

Overall our proposed assistance requests are in line with prior year programs and our 1986 request. The increases above 1986 appropriations represent an attempt to keep programs at the previously requested levels. In FY 87 our total economic assistance request for EAP is $250 million and military assistance is $492 million.

Our assistance programs concentrate on the region's more threatened or vulnerable nations: the Philippines, the Republic of Korea and Thailand.

The assistance program for the Philippines was prepared before the recent tumultuous events there and we are carefully reviewing the elements of our future program. The fundamental objectives of seeking structural reforms needed to put its economy back on the path of growth and military assistance to help promote reform and development of a professional military capable of meeting the challenge posed by the communist insurgency will remain the same. We must also fulfill the President's "best effort" commitment in the context of the last 5-year review of the military bases agreement.

In Korea, tensions remain high despite the beginnings of a welcome dialogue between Pyongyang and Seoul. The threat of North Korean aggression remains serious and immediate. We and our South Korean ally must remain especially vigilant during the period leading up to the 1988 Seoul Olympics which Pyongyang bitterly opposes. As our Korean ally is already devoting a large portion of its GNP to defense, continued FMS credits are needed if Korea is to meet the key objectives of its Force Improvement Plan.

Thailand needs our assistance to achieve its development goals so that it can maintain a healthy economy in the face of economic problems and effectively carry its share of our mutual security burden. Like Korea, Thailand is an ally allocating substantial resources to badly needed military modernization and the creation of a credible deterrent to Vietnamese aggression.

The Soviet challenge dramatizes again the importance of the ASEAN nations which sit astride the vital sealanes joining Asia with the Middle East and Europe. The United States and the free world have a critical interest in this important part of the world. Our security assistance programs in Malaysia, Singapore and Indonesia and our economic assistance program in Indonesia help ensure this stability. Just as our assistance to Thailand is part of our commitment to these ASEAN states, so is our backing of the noncommunist Cambodian resistance. We and the ASEAN nations are committed to assisting these non-communist forces.

Finally, in the Pacific itself, we see the most active Soviet interest in an area of strategic importance to the U.S. The regional fisheries agreement we are negotiating as well as our continuing small assistance programs are a small price to pay to protect our interests.

As you can see our programs in East Asia and the Pacific, which make up only a modest portion of our world-wide foreign assistance requests for FY 1987, are an important part of our policy in this key area of US interest.

Mr. Chairman, I would now like to review the individual country programs in some detail.

## THE PHILIPPINES

Our security assistance request for the Philippines is designed to address the critical needs of a key allied nation which has just undergone a historic and peaceful change in leadership and which continues to face a combination of political, economic and security problems. In addition, the program is designed to support a vital defense relationship, including key support facilities for U.S. forces which are located in the Philippines.

The basic framework for our request is a Presidential "best effort" commitment made in connection with the five-year review of our Military Bases Agreement in 1983. By letter to the Philippine head of state, former President Marcos, the President indicated his intention to seek a total of $900 million in security assistance ($125 million MAP, 300 million FMS, 475 million ESF) for the Philippines during the five-year period FY 85 to FY 89. Continuation of our assistance under this commitment would now serve to underscore the importance which we attach to this commitment which was made to the legitimate government and people of the Philippines, not just to the Marcos regime.

Our security assistance thus relates closely to our ability to maintain unhampered use of Clark Air Base, Subic Naval Base and related installations, facilities that are crucial to our capability to protect the sea and air lanes of East Asia and much of the Pacific region, and to provide logistical support for U.S. forces in the Indian Ocean and Persian Gulf. It also signals U.S. interest in helping the Philippines overcome its economic problems.

Developments since the Presidential commitment was made have rendered the need for assistance all the more acute. As you are aware, we have just witnessed one of the most stirring examples of the democratic process in modern history. In extending recognition to President Aquino's Government, Secretary Shultz stated, "We honor the Filipino people and stand ready to assist the Philippines as the Government of President Aquino engages the problems of economic development and national security."

The Philippines has been plunged into its most critical economic crisis since World War II, and the economic outlook remains bleak in the short-to-medium term. The country registered negative real GNP growth of around 5.5 percent in 1984, and a further drop of about 4 percent in 1985. Positive real GNP growth may not resume until 1987, and then only at a modest rate. The need to restrict government expenditures, curtail imports and service a large external debt will weigh heavily on the Philippines for the remainder of this decade.

As it seeks to cope with economic crisis, the new Government of the Philippines also faces the challenge of a growing communist insurgency. The communist New People's Army (NPA) now numbers some 20,000 armed guerrillas, with about as many part time guerrillas, a very dramatic increase over the numbers we reported to you last year at this hearing. The NPA has expanded its operations to the rural areas in almost all provinces in the country. Assassination squads, called Sparrow Units, and NPA cells are also active in Philippine cities. The root causes of the insurgency are political and socio-economic, and must, of course, be addressed as such.

We believe that the new government is well aware of this fact and will try to combine a program of overall economic growth for the country with an amnesty/reconcilation/ jobs-training program to provide an incentive for non-ideologically committed guerrillas, which hopefully will be the majority, to reenter the mainstream and begin new lives.

However, there are communist guerrillas and party members who are committed Marxists and seek to establish a Marxist-style totalitarian state in the Philippines by both political and military means. This dimension of the insurgency poses a challenge to the Aquino government which requires an effective, coordinated civil/military response from the new government and the Armed Forces of the Philippines.

Exchange shortages and budgetary restraints -- Philippine defense expenditures have declined by more than 20 percent in real terms since 1978 -- have severely restricted resources available to the Armed Forces of the Philippines (AFP) to play its role in a comprehensive approach to the insurgency. The current economic crisis, deepened by the extravagant election spending of the Marcos government, will make it even more difficult over the short and medium term for the AFP to receive the resources necessary to implement the necessary reforms and effectively meet the military challenge presented by the communist guerrillas.

On the economic front, President Aquino has put together a highly qualified team to deal with the serious economic problems confronting the Philippines and the reforms necessary to deal with them. Initial discussions with members of the new Government's team indicate that they want to pursue an economic program which emphasizes deregulation, breaking monopolistic practices, and greater reliance on the market to lead economic recovery. We hope the new Government will commit itself to implement the economic reforms which many Filipino business people, bankers and acadamicians have been advocating for some time. We view these commitments as necessary to restore growth and vitality to the economy.

In the military area, we are encouraged by signs over the past few days that the new Philippine government and the new leadership of the AFP accept the necessity of far-reaching military reform and are taking steps to make the AFP a non-political, professional institution and to restore it to combat-effectiveness. One factor which previously inhibited a serious response to the issues of military reform and the insurgency was the politicization of the military by former President Marcos. The Marcos administration and the senior ranks of the AFP did not provide the requisite civilian/military leadership for a comprehensive civil/military program to counter the insurgency.

With the retirement of 23 overstaying generals, announced by President Aquino last week, and the appointment of competent, reform-minded officers to leadership positions, the AFP is getting back on the right track. It is important that we support this process of reform which we have been encouraging for the past two years.

When General Ramos was Acting Chief of Staff last year, although he was held in check by the Marcos/Ver loyalists, he was able to institute a modest program of military reforms. This program included:

-- A new system to deal with military abuse cases;
-- Some reorganization to deal with insurgency;
-- A more realistic set of military procurement priorities.

Our military assistance proposal is made in the expectation that now that General Ramos and other professional officers have a mandate from President Aquino to conduct overdue reforms, the positive trends already apparent will continue and strengthen, and a new AFP will emerge.

Our proposed assistance package for FY 87 is designed both to ensure fulfillment of the Presidential "best effort" commitment and to address the seriousness of the problems now facing the Philippines. The levels requested for FY 87 still represent the Administration's request at this time. Including Development Assistance and PL 480, we have requested a total of $228.43 million in aid to the Philippines, $125.68 million of which is economic. The full amount is certainly required. The new government is still evaluating the country's economic condition and does not yet have a clear picture of what it may require in foreign assistance.

We are now consulting with the new government in an effort to assess needs and determine how we can be helpful. Ambassador Habib began the process during his most recent visit to Manila. We will also be examining with other countries and multilateral institutions the programs they plan in the Philippines.

Our request for a total of $100 million in military assistance ($50 million MAP/$50 million FMS) aims at making up some of the shortfall in military assistance resulting from the last two years' Congressional action. In FY 85 $45 million in proposed FMS was shifted to ESF. In FY 86 approximately $24.63 million of our request for $100 million in FMS and MAP was shifted to ESF and the overall request was pared down to $52.64 million.

The Presidential "best effort" letter specifies that a total of $425 million in military assistance ($125 million MAP/$300 million FMS) will be sought during the five-year period. With military assistance reduced to $40 million in FY 85, and $52.64 million in FY 86, we need to begin to increase military assistance over the base-line level of $85 million if we are to fulfill the President's commitment during the five-year period.

Equally important in determining the level of military aid for FY 87 is the AFP's concrete need for such assistance if it is to mount an effective military response to the insurgency challenge. The reduced level of FY 86 military assistance will be almost totally absorbed by operations and maintenance costs in support of existing inventory. Serious AFP shortcomings in maintenance, logistics, transportation, communications and training that can only be overcome through adequate levels of foreign assistance. Over the next few years military assistance levels at least equal to those embodied in the five-year Presidential commitment are essential. Our IMET request of $2.75 million, aimed at improving the leadership and performance, also addresses an important AFP need.

Our proposal that military assistance consist of equal portions of MAP and concessional FMS credits flows from current and projected international payments calculations. In FY 84 repayments of $50.5 million on previous market rate FMS credits exceeded new credits of $50 million. In the absence of Paris Club debt rescheduling, repayment obligations resulting from FMS credits would have again exceeded new inflows of military grants and credits in FY 85, and projected repayments are expected to reach $48 million in FY 86. This increased debt burden comes at an extremely difficult time for the Philippine economy, with its overall ratio of debt service to exports at around 50 percent prior to debt rescheduling.

The severity of the economic situation also makes it imperative that ESF be maintained at the base-line level of $95 million. Given the Philippine's economic prospects for the next few years it is difficult to provide anything less in view of the urgent need to assist economic recovery. In programming ESF we recognize that providing government services to address the economic and social conditions in rural areas which allow insurgencies to prosper is as least as important as military operations. ESF programming will continue to be linked with the overall development assistance strategy in the Philippines.

In addition to security assistance related to our bases arrangements, we propose that Development Assistance be set at $23 million. We have also requested $7.628 million in PL 480 Title II to continue feeding programs that have been rendered even more important by the deteriorated economic situation.

Our policy towards the Philippines rests on the premise that fundamental political, economic and military reforms are needed if stability is to be preserved and economic health restored. The new government appears committed to putting together a program to address these reforms. A central objective of our assistance is to contribute to the new government's ability to address the critical problems facing the Philippines and to help the government carry out the needed reforms.

We are reviewing our aid program, in the context of other bilateral and multilateral donor plans, to see how it can be structured to respond to the needs and initiatives of the new Philippine Government. AID Administrator McPherson is leading a joint State-AID-Treasury-Defense team that is now in Manila for that purpose. If our review shows that the aid requirements of President Aquino's Government exceed the amounts we have requested, we shall have to consider our options. If it becomes necessary after considering such options to change the level of our FY 87 request, or to make changes in FY 86, that would be communicated to the Congress as quickly as possible through our established process. We will certainly need the support of the Congress as the new Government engages the urgent economic and security problems it has inherited.

Mr. Chairman, a lot has happened in the Philippines in recent years, and especially in recent weeks. A key allied nation, under new, popularly elected leadership, faces significant challenges on a variety of fronts. It is incumbent upon us to do what we can to help the new government and the Filipino people get through this crucial period and establish a foundation to lay the basis for future stability and prosperity.

## KOREA

Renewed hostilities on the Korea peninsula would directly affect the security interests of the United States, the USSR, the PRC and Japan, and could have global and as well as regional consequences. Deterrence of North Korean aggression against the Republic of Korea is therefore an essential component of peace in the region. For over 30 years, the US-ROK alliance has been successful in deterring a North Korean attack. Nonetheless, the cessation of hostilities brought about by the Armistice Agreement has been marred over the years by such incidents as the 1968 raid on the Blue House by North Korean commandoes, the seizure two days later of the U.S.S. Pueblo, and North Korean tunneling under the DMZ. In 1983 in an attempt to assassinate ROK President Chun, 17 senior South Korean officials were killed by a bomb which a Burmese court determined was planted by North Korean commandos. Yet war has been prevented, and this has allowed great economic and social progress in South Korea.

In spite of the Republic of Korea's impressive economic development, its need for continued US security assistance is strong. In the past decade, North Korea, which spends over 20% of its GNP for military outlays, has carried out a major force buildup. The military balance continues to favor the North. North Korea has about 750,000 men under arms, compared with 620,000 in the South. However, even these numbers substantially understate North Korea's superiority, because non-military units carry out extensive support functions for the offensively oriented North Korean ground forces.

North Korean forces are well equipped and have a substantial numerical advantage (at least 2-to-1) in several key categories of offensive weapons: tanks, long-range artillery, and armored personnel carriers. They also have more than twice as many combat aircraft as the South, although ROK-US forces have the qualitative edge. In 1985 the USSR began to supply North Korea with MiG-23s. North Korean exercises have revealed impressive sophistication in joint and combined maneuvers.

In addition to the size and capabilities of North Korean forces, the challenge they pose is compounded by factors of time and distance. The bulk of North Korean forces are deployed well forward, along the DMZ, about 25 miles from Seoul, and North Korea has recently begun to construct additional underground fortifications near the DMZ. The North also has perhaps the world's second largest commando force (after the USSR) designed for insertion behind the lines in the event of war. Thus, warning time for ROK and US forces is very limited, and a high state of readiness is a constant requirement.

To counter this threat the ROK, which spends about six percent of its GNP on defense, is engaged in a major force improvement program designed to augment its effective firepower and enhance its air defense capability.

To assist the defense efforts of this front-line ally, with whose troops American soldiers would fight side-by-side in the event of North Korean aggression, we will provide $162.7 million in FMS credits in FY-86 and are requesting $230 million in FY-87. For the last two years FMS credits have been provided to Korea on terms of 10 years' grace on repayment of principle and 20 years' repayment. This allows Korea to devote a larger proportion of each year's allocation to actual purchases, thereby permitting the Force Improvement Program (FIP) to proceed on schedule. In 1987 we are also requesting $2.2 million in IMET funds for professional and technical military training.

Our Korean ally is doing its utmost for its own security. In the past it has spent some 3 to 4 times the amount of its FMS credit level for military purchases in the US. It is clearly in our interest to help Korea meet its force improvement goals and mutual security objectives. I believe that helping Korea maintain a strong defense with adequate FMS credits is very much in our own interest.

## THAILAND

Thailand is a close a friend and ally to whose defense and security we are committed under the Manila Pact. The important relationship we have developed over the years is based on a shared commitment to the values of freedom and independence. Since 1978, Thailand has been the front line ASEAN state confronting Soviet-supported Vietnamese aggression against Cambodia. In addition to our bilateral responsibilities, our assistance is also viewed as a gauge of the reliability of our commitment to Thailand and our support for ASEAN generally. To maintain our interests in the region, we should help to sustain our friends.

On its eastern border, Thailand faces a strong, active military threat from a combat-hardened Vietnamese army. Vietnamese attacks on the Cambodian resistance groups have escalated since Vietnam invaded Cambodia in 1978 and incursions into Thailand and clashes with Thai troops have increased in number and severity. This threat has prompted an overdue modernization of Thailand's military forces. We support this modernization program which, in conjunction with other efforts, aims to provide a deterrent to further Vietnamese aggression. It will enable Thailand to become more self-reliant in an emergency and able to shoulder effectively its portion of our shared security responsibilities.

Our assistance package is important to Thailand's economic management. Although the Thai economy grew strongly for two decades up to 1982, the international recession has hurt traditional exports and slowed growth. Foreign debt and the trade deficit have mounted. The Royal Thai Government has taken courageous steps to address these problems but faces a period of painful adjustments. Thailand traditionally has managed to balance its allocation of resources, giving social and economic development a high priority while also providing for necessary military expenditures. Our security assistance has helped the RTG maintain this balance in the face of growing demands on limited resources. Our economic assistance, while not large in terms of total resources, has been directed to help Thailand address the problems of rural growth and employment, and strengthening its ability to join the ranks of middle income countries.

Our development assistance request of $19 million shows a small decrease from last year. However, it represents an important contribution toward achieving Thailand's development goals in the face of increasing security requirements. Working closely with the Thai government we have shifted the emphasis of our program as the Thai economy has changed. Our program will now emphasize two new areas - the creation of jobs in rural areas through the promotion of small industrial enterprises and assistance in the field of science and technology.

Our request for $5 million in Economic Support Funds, straight-lined from last fiscal year, is directed to the Thai need for assistance in helping the war-torn rural communities along the Cambodian border. The spill-over of fighting into their homes and their livelihoods make the people in these communities deserving of special help and compassion. The ESF funds also contribute directly to upholding Thailand's humane policy offering asylum to refugees and other displaced persons by assisting the Thai border villages affected by the refugee influx.

For FY-87, we are requesting $103.5 million in FMS funding for Thailand. In the face of the strains on the Thai economy caused by limited trade prospects and the need to establish a credible deterrent to Vietnamese aggression, however, we recommend a significant concessional element in our assistance package. We have requested that $61.0 million in FMS be provided at concessional rates while the balance of $42.5 million would be extended on terms providing 10 years' grace and 20 years repayment of principle. These funds will help finance a long overdue upgrading of equipment by all the services as well as purchases of necessary expendable items which will enhance sustainability.

Our MAP request is again for $5 million, and is intended to ease the cost to the Thai of necessary equipment purchases.

In 1987, we are requesting $2.5 million in IMET funds. These training funds have become all the more important as the Thai military absorbs more sophisticated systems with attendant challenges to technical competence and logistics support. The Thai consistently put this training to effective use to upgrade their capabilities in technical and command subjects.

## INDONESIA

Indonesia, the world's fifth most populous country, plays a key leadership role in both Southeast Asia and in the broader Pacific Basin. Its geo-strategic importance and hence its importance to the United States cannot be overrated. Indonesia is also an important leader in the Non-Aligned Movement and its role as a moderate in that forum is a valued one. Indonesia also ranks among the moderates in the Islamic movement and has played constructive roles in many international organizations. Development and security assistance to Indonesia is part of our strong support for the ASEAN which in our view represents the best hope for peace, stability and economic and social development in Southeast Asia. A consistent development assistance program for Indonesia is necessary to increase manpower and management skills and to promote the private sector's role in economic development.

Uncertainties regarding oil and natural gas revenues, which account for more than 60 percent of the Indonesian budget, are expected to continue for several years and the Indonesian Government is expected to be hard-pressed. At the same time, the Indonesian Government has responded to the recession and declining oil revenues in a most responsible way by undertaking self-imposed austerity and reform programs. In addition, the government undertook a sweeping reform of the financial sector by removing interest rates and lending controls, increasing tax revenues and broadening the tax base, and reviewing regulations inhibiting the growth of the private sector.

Development assistance of $55.4 million is being requested for FY 87. Budgetary constraints have dictated a $15 million reduction in PL-480/Title I assistance to $15 million. PL-480 assistance to Indonesia continues to be a high priority because food stocks need to be maintained at acceptable levels in order to forestall hardship and public unrest, as well as provide for adequate emergency shipments of food to impoverished or disaster-struck areas. A PL-480/Title II request of $4 million supports voluntary agency programs and World Food Program operations.

Although Indonesia has wisely slowed the pace of its military force modernization in the face of recent and continuing economic problems, U.S. security assistance has helped to sustain a number of important programs, including aircraft maintenance and spare parts, ship overhaul and spare parts, improvements in air and sea defense systems, the purchase of war reserve munitions and, most importantly, advanced and specialized training for commanders and management personnel in the Indonesian army, navy and air force. Added emphasis this year is expected to be given to "train the trainers" programs which would measurably improve indigenous training capabilities.

Indonesia's military forces remain critically short of qualified technicians and program managers. U.S. training primarily will be in technical fields and the level of IMET funding requested should permit approximately 250 military officers to attend our armed forces schools in FY 87. IMET deserves the highest priority support because of the important role played by the professional military in the Indonesian society, the utility of the program in furthering our foreign relations objectives and the desirability of improving mutually beneficial service-to-service contacts.

The requested FY 87 security assistance program for Indonesia consists of $2.8 million in IMET funding, plus $35.0 million FMS direct loans at concessional interest rates. Concessional rates are considered necessary to assist Indonesia in recovering from the effects of the global recession in the early 1980's and to overcome serious budgetary shortfalls due to declining oil and non-oil export revenues.

## MALAYSIA

Strategically located on the Malacca Strait, Malaysia's continued political stability and economic development are essential to U.S. interests in the ASEAN region. Confronted with the Vietnamese occupation of Cambodia and the consequent threat to regional peace and stability, Malaysia has been in the forefront of ASEAN's strategy to bring about a withdrawal of Vietnamese forces from Cambodia and a negotiated settlement ensuring the rights of the Khmer people. Beyond Southeast Asia, Malaysia is a responsible member of the Islamic Conference and Non-Aligned Movement and has played a constructive role in international affairs generally.

U.S.-Malaysian relations, founded on mutual respect and common interests, are very good and were enhanced further by the visit to Washington in early 1984 by Prime Minister Mahathir bin Mohamad. There have been subsequent exchanges of high-level visitors, including Secretary of State Shultz in July of 1985. The Malaysians are interested in continued defense cooperation with the United States, taking into account Malaysia's non-aligned status, and U.S. security assistance is designed to augment their legitimate self-defense capabilities, thus contributing to the security of all of the ASEAN countries.

The $5 million FMS request level for Malaysia in FY 87 is designed to provide continuity in the program as Malaysian military planners consider force restructuring away from counter-insurgency to a more conventional force posture which will create new equipment needs. Although Malaysia has not in the past made extensive use of FMS credits, additional purchases are likely as its economy improves. Possible purchases include surveillance equipment, anti-ship weapons, and Sidewinder and Maverick missiles.

The IMET request of $1.23 million is a slight increase from last year, and is to some extent based on the increased cost of training. The IMET program provides an important means for the Malaysian armed forces to meet their training needs as they adjust to a more conventional force structure and acquire more sophisticated weapon systems. The Malaysian Government considers exposure to U.S. defense management, operational doctrine, and support concepts critically important to the modernization of its armed forces.

## SINGAPORE

Singapore plays an important role within ASEAN and occupies a pivotal strategic position in Southeast Asia by virtue of its location at the juncture of the Pacific and Indian Oceans. Singapore is a valuable port of call for U.S. ships transiting the Malacca Strait and offers important ship and aircraft support facilities. A non-aligned nation, Singapore plays a significant moderating role with the Non-Aligned Movement and in UN and other international fora. Singapore has stood up forthrightly in opposition to Soviet actions in South and Southeast Asia, and Singaporean leaders have publicly called for the United States to maintain a continuing regional security role as a deterrent to Soviet expansionism. Additionally, Singapore has strongly supported ASEAN's strategy for achieving a political settlement of the Cambodian problem and an end to Vietnamese occupation of that country. In FY 87, we are requesting a modest $75,000 for training under IMET for Singapore.

## CAMBODIA

Last Year the six ASEAN countries issued an appeal for the world community to "assist the Cambodian people in their political and military struggle" to free their country from Vietnamese occupation. Representative Stephen Solarz proposed a program of assistance to supplement the ongoing USG diplomatic effort to provide political and moral support for the non-communist Cambodian resistance groups. The Administration welcomed this initiative as a concrete demonstration of the support of the American people for the Khmer resistance cause; and Congress authorized up to $5 million for the non-communist resistance forces in either ESF or MAP for both FY-86 and FY-87. The FY-86 appropriation placed a floor of $1.5 million on this account, and the Administration decided to allocate $3.5 million in ESF of the $5 million authorized (reduced to $3.35 million after GRH sequestration). The Administration also decided that, because other countries are supplying sufficient arms and ammunition to the non-communist resistance, the USG should provide only non-lethal training and equipment under ESF, foregoing MAP.

This small grant of assistance is a key element in demonstrating our support for ASEAN's effort to persuade Vietnam to accept a negotiated settlement in Cambodia and to return that unfortunate country to the control of its own people. ASEAN's united approach in dealing with Vietnamese aggression has been a major factor in preserving the security of Thailand and political and economic stability in all of Southeast Asia. The Administration is planning to implement the program in cooperation with the Thai government.

For FY 87, we are requesting that the full $5 million authorized be funded in ESF. A modest increase over the FY-86 level in this very small program would be a powerful signal of our continuing support for the ASEAN cause.

## BURMA

We are pleased with the continuing upward trend in our relations with Burma. The Burmese Government, while firmly committed to nonalignment, pursues a foreign policy that is not incompatible with our own strategic interests in southern and southeastern Asia. Moreover, the Burmese leadership's gradual movement away from strict isolationism has led to increased contacts between our governments and to expanded bilateral cooperation in areas of mutual concern such as narcotics control.

The Burmese Government faces an array of domestic insurgent and warlord groups, including the Burma Communist Party, that control large areas of the hinterland and finance themselves through narcotics trafficking and other illegal activities. The effectiveness of the Burmese military is the key to Burma's efforts to control these groups and their narcotics activities and, over time, to achieve stability and economic progress in the country.

In December 1985 the Government with our assistance launched a program for the aerial eradication of opium poppies. This is the first such program in Southeast Asia, and gives the Government the capability to destroy poppy cultivation in previously inaccessible areas.

Despite substantial natural resources, Burma ranks among the world's poorest countries. It has a *per capita* income of less than US$ 190, estimated foreign currency reserves of less than $50 million, and a debt-service ratio that is approaching 45 percent.

The $10 million in Development Assistance proposed for FY-1987 will enable AID to continue its support of Burmese efforts to improve rural primary health care, to increase agricultural research, and to improve the production and processing of secondary food crops to reduce Burma's dependence on rice exports to earn badly-needed foreign exchange. The AID projects, tightly focused on specific and achievable goals, have been well-received by the leadership and people of Burma, and have contributed measurably to a strengthening of our bilateral relationship.

The $1 million MAP grant proposed for FY-1987 will enable the meagerly-equipped Burmese military to strengthen its position against the insurgents, and contribute to the effectiveness of our bilateral narcotics control efforts. The proposed $350,000 for IMET will assist the Government to develop its own training capability while providing Burmese military officers direct exposure to American society and values. Because of the military's critical role in Burma, this could have a favorable long-term effect on our bilateral relations.

## PACIFIC ISLANDS

For the first time since World War II we are faced with a hostile power attempting to expand its influence in the South Pacific. This threatens a primary goal of U.S. policy in the region, the strategic denial of the area to outside hostile forces, as it does the political environment in which we operate in the region.

This Administration has accepted, and I would like to think improved upon, the South Pacific policy followed by every administration since the War. That policy recognizes that the U.S. has an undisputable national security interest in assisting and promoting the economic growth of the island governments of the South Pacific, a region remarkable in the developing world for its effective and vigorous democratic institutions. This policy has paid dividends by keeping the ports and airfields of the region open to U.S. warships and aircraft, and in a consistent history of island support of the U.S. in international fora on matters of vital national security interest.

In Fiscal Year 1987 we are seeking $4.5 million in Development Assistance to support our regional program in the South Pacific, aimed primarily at private sector growth, agriculture, health and education in ten of the region's eleven independent or self-governing nations.

## CCOP/SOPAC

This is perhaps the single best example of how our assistance has prevented Soviet inroads into the region. The Committee for the Coordination of Offshore Prospecting, South Pacific (CCOP/SOPAC), a research project funded jointly by the United States, Australia, and New Zealand, was put together as a response to a 1980 Soviet offer of a similar program. The island states unanimously rejected the Soviet offer and accepted ours. The program has attracted favorable comment from island leaders, enhancing our position in the region. Private sector interest in potential seabed mining and drilling has also focused on the region as a result of this project. The requested level of funding ($1.5 million in ESF) is needed to meet our commitments to the other sponsors and the island states.

## REGIONAL FISHERIES DEVELOPMENT

The $1.5 million ESF regional fisheries development program is, like CCOP/SOPAC, a counter to Soviet moves in the region. Island states whose major or only resource is their fishery are under severe budgetary pressure to accept Soviet offers to pay for fishing rights. While the amount requested is approximately what the Soviet Union is paying annually for fishing rights in one country (Kiribati), our program is attractive to the island governments because is helps them develop their own resources rather than simply license them to others. We hope to involve the U.S. private sector in this initiative.

## FIJI

Fiji has been one of our staunchest supporters in the region. When the U.S. has needed a friend, or when an especially egregious act by the Soviet Union demanded public condemnation, Fiji always has been ready to speak out. It has opened its ports to our warships at a time when powerful political forces in the region opposed such a move, and it has played a constructive and useful role in our on-going negotiation of a regional fisheries agreement. Fiji continues to participate in UNIFIL and in the Sinai MFO. We hope to begin a bilateral program this year with $1.5 million in ESF and $400,000 in Development Assistance. Our small IMET program ($125,000) is intended to provide needed professional and technical training to the Royal Fiji Military Forces (RFMF) and thereby assist it in carrying out its peacekeeping duties in the Middle East. The MAP program ($300,000) is designed to standardize RFMF small arms on the M-16.

## PAPUA NEW GUINEA

Despite a democratic change of government at the beginning of this calendar year, the Government of Papua New Guinea (PNG) continues to remain friendly to the U.S. and an outspoken supporter of a strong U.S. presence in the region. The largest and potentially richest of the South Pacific island nations, has been especially supportive of our efforts to negotiate a regional fisheries agreement. The modest $85,000 IMET program proposed for PNG in FY 87 is designed to provide the PNG Defense Force with needed skills to assist it in managing its scarce resources.

## TONGA

Tonga has never hesitated in its open, public support of a U.S. military presence in the region and has welcomed U.S. ship visits when no other island state seemed prepared to do so. Our FY 87 IMET program for Tonga ($60,000) is intended to provide greater technical skills to the Tongan Defense Force and strengthen the professionalism of its officer and petty officer corps.

SOLOMON ISLANDS

The Solomon Islands exercises considerable influence in the region on fishery and nuclear issues. It has generally supported U.S. interests in international fora, and our relations in areas where we have differences are characterized by a political will to resolve problems and reach accommodations. The Solomon Islands Defense Force is small and in need of training. Our small $60,000 IMET program for FY 87 is designed to provide basic management and technical skills to the officer and petty officer corps.

Mr. Chairman, we believe in the current austere budget environment that our programs for East Asia and the Pacific represent a lean and realistic approach to meeting US needs in this vital region.

Mr. OBEY. Okay. Who wants to go next?

Mr. KELLY. I will go next, Mr. Chairman.

Thank you for this opportunity to present a Defense view on the Administration's fiscal year 1987 foreign assistance request for East Asia and the Pacific. I will abbreviate my statement, sir, and ask that the entire statement be entered into the record.

Mr. OBEY. Sure.

Mr. KELLY. This security assistance request for East Asia and the Pacific represents a very carefully constructed program. And it is my view that the requested levels are fully justified. Frankly they are less than what we really need, but we have made a determined effort to keep the request at a minimum prudent level in view of budget constraints.

I would like to very briefly address three major security assistance programs: Philippines, Republic of Korea, and Thailand.

In the Philippines, the success of the bloodless transition of government authority stands as a remarkable achievement of the Philippine people and their armed forces. The U.S. Government played a constructive and supportive role during this important event. We look forward to working with President Aquino and her government to help contribute to the Philippines national development.

The goals of our security assistance program in the Philippines are to assist the armed forces of the Philippines in restoring military professionalism and rebuilding effective military capabilities. Restoring military professionalism means respect for democratic institutions, loyalty to civilian authority, and skill in the organization and application military strength. It means leadership.

Last year Defense witnesses shared with the Congress our belief that the AFP, Armed Forces of the Philippines, had a solid core of professional military officers who were capable of attacking the problems of the Philippine military and developing a successful counterinsurgency strategy. We pointed specifically to the AFP reform movement led by middle grade graduates of the Philippine Military Academy as the indicator of the existence of a thriving professional spirit.

Our representations were met with some skepticism. History and the AFP, however, have vindicated our judgment.

Rebuilding effective military capabilities is a function of resources, training, and, of course, leadership. The AFP has suffered through an extended period of underfunding and neglect. The current economic crisis in the Philippines, the most severe since World War II, has contributed to a significant lack of resources for the AFP. So, too, has the political uncertainty adversely affected military leadership.

Changes in the AFP leadership instituted by the new government hold great promise for revival of effective leadership at all levels of command. Lack of resources will, however, remain a paramount problem for the development of effective military capabilities.

The importance of the task of rebuilding the AFP cannot be underestimated. Despite the euphoria of the moment, the Philippines continues to face major problems, including a virulent armed communist insurgency. The leaders of the New People's Army have made clear to the government that they do not intend to lay down their arms.

If the Aquino government is to have an opportunity to succeed in introducing vital social, economic and political reforms, that government must have the capability of establishing order and defending itself against those who are committed to its violent overthrow.

Our efforts to help the new government of the Philippines to promote military professionalism and rebuild the capabilities of the armed forces in the Philippines are occurring in two phases. The first phase is represented by the President's request for $100 million in military assistance for FY-87, 50 million in military assistance, $50 million in FMS credits, plus 2.2 million in IMET.

I might point out, sir, that this is a part of the five-year "best efforts" pledge that was made at the time of the last review of the U.S.-Philippines military bases agreement.

That "best efforts" pledge called for $425 million in military assistance over the five-year period from 1985 to 1989. During the first two years of that five-year period, the Congress has appropriated slightly less than $95 million in military aid, leaving about $330 million for the next three years if the "best efforts" pledge is to be fulfilled.

The second phase of our program involves continuing consultations with Philippine government officials and military leaders. And these are just beginning as a low key part of the McPherson mission now in Manila. We do believe though that after the policy determination has been made, some additional resources will be required. But for the present, we stand with the $100 million Administration request.

Now, with respect to Korea, Mr. Chairman, the Soviet Union certainly poses the greatest threat to U.S. interests in Asia and the Pacific. But it is clearly not the only source of regional instability. Maintaining peace and stability in Northeast Asia, where the interests of the U.S., Japan, China, and the Soviet Union converge, is a vital concern.

Renewed conflict on the Korean Peninsula would put at risk the stability of the region and political relationships of the major powers there. Despite devoting almost 6 percent of GNP to defense, the Republic of Korea has been unable to match the massive North Korean military buildup which began in 1970 and continues to this day.

The North Korean military now poses as great a threat to the ROK as at any time since the Korean War. The North Korean Army is about 40% larger than the ROK ground forces with almost twice as many maneuver units, tanks, artillery pieces, and armored personnel carriers. Defense spending in the Republic of Korea accounts for approximately one third of its governmental budget, about $4.8 billion, which is almost 6 percent of GNP. About half of the almost $9 billion which the ROK will spend for investment during a multi-year period will be spent in the United States. This amount, about $500 million annually over and above the FMS credit allocation, greatly exceeds in value our assistance for Korea.

Our request is for $230 million in security assistance—and this is in FMS treasury rate credits—to Korea. These loans equate to only five percent of the ROK defense budget. But it is an important 5 percent.

Last year security assistance for Korea was reduced considerably below our planned levels because of budget constraints. With the Asian Games scheduled this year, and the elections and the Olympic Games in 1988, Korea is entering perhaps its most dangerous era in 30 years. We cannot risk a further reduction in our support for its defense.

With respect to Thailand, I will simply point out that this is another country with which we have an alliance relationship. It is suffering from a serious problem on its border with Vietnamese forces, including incursions by the Vietnamese into Thailand. And we believe that our support of the Thai Arm Forces is of great importance.

Mr. Chairman, I will conclude my remarks with that.

[Statement follows:]

# FY 1987 SECURITY ASSISTANCE IN EAST ASIA AND THE PACIFIC

Statement before the
Subcommittee on Foreign Operations
of the
Committee on Appropriations
House of Representatives

James A. Kelly
Deputy Assistant Secretary of Defense
(East Asia and Pacific Affairs)
March 12, 1986

NOT FOR PUBLICATION UNTIL RELEASED BY THE SUBCOMMITTEE

Mr. Chairman,

Thank you for this opportunity to present a Defense view on the Administration's FY 1987 foreign assistance request for East Asia and the Pacific. I recognize that, at a time when budget deficit reduction has the attention of the Congress, security assistance must undergo close scrutiny. It is sometimes difficult to understand how our aid to allies and friends promotes our own defense interests abroad. Nevertheless, we know that a strong, coherent, and reliable security assistance program, adequately funded by Congress, is an absolutely essential complement to our efforts to strengthen America's defenses. This security assistance request for East Asia and the Pacific represents a very carefully constructed program and it is my view that the requested levels are fully justified. Frankly, they are less than we really need, but we have made a determined effort to keep the request to minimum prudent levels in view of budget constraints.

Last year I spoke to this Subcommittee on the importance of security assistance for our defense strategy in East Asia and the Pacific, its indispensable role in gaining us access to bases and overflight rights and in improving our forward deployed defense capabilities. The Soviet military presence in the region has continued to grow dramatically over the past year, and our need for strong deterrence and effective defense has not diminished. Secretary Weinberger will be visiting East Asia and the Pacific in the near future to reinforce our commitment to remain a Pacific power and our support for allies and friends in this strategically important and dynamic region.

Today I want to address three major security assistance programs in Asia and the Pacific: the Philippines, the Republic of Korea, and Thailand.

PHILIPPINES

The success of the bloodless transition of government authority in the Philippines stands as a remarkable achievement of the Philippine people and their armed forces. The US Government played a constructive and supportive role during this important event. We look forward to working with President Aquino and her government to strengthen our historic friendship and contribute to the Philippines' national development.

The goals of our security assistance program in the Philippines are to assist the Armed Forces of the Philippines (AFP) in restoring military professionalism and rebuilding effective military capabilities.

Restoring military professionalism means respect for democratic institutions, loyalty to civilian authority, and skill in the organization and application of military strength. It means leadership. Last year, Defense witnesses shared with the Congress our belief that the AFP had a solid core of professional military officers who were capable of attacking the problems of the Philippine military and developing a successful counterinsurgency strategy. We pointed specifically to the AFP reform movement, led by middle grade graduates of the Philippine Military Academy, as an indicator of the existence of a thriving professional spirit.

Our representations were met with some skepticism. History and the AFP, however, have vindicated our judgments.

Rebuilding effective military capabilities is a function of resources, training, and, of course, leadership. The AFP has suffered through an extended period of underfunding and neglect. The current economic crisis in the Philippines -- the most severe since World War II -- has contributed to a significant lack of resources for the AFP. So, too, has political uncertainty adversely affected military leadership. Changes in the AFP leadership instituted by the new government hold great promise for a revival of effective leadership at all levels of command. Lack of resources will, however, remain a paramount problem for the development of effective military capabilities.

The importance of the task of rebuilding the AFP cannot be underestimated. Despite the euphoria of the moment, the Philippines continues to face major problems, including a virulent armed communist insurgency. The leaders of the communist New People's Army have made clear to the government that they do not intend to lay down their arms. If the Aquino government is to have an opportunity to succeed -- to introduce vital social, economic, and political reforms -- that government must have the capability to establish order and defend itself against those who are commited to its violent overthrow.

Our efforts to help the new Government of the Philippines to promote military professionalism and rebuild the combat capabilities of the Armed Forces of the Philippines are occurring in two phases.

The first phase is represented by the President's request for $100 million in military assistance for FY 87 -- $50 million in MAP and $50 million in FMS credits, plus $2.2 million in IMET. Last year, US and Philippines officials, working together, developed a program for effective utilization of security assistance to be made available as a result of the President's "best efforts" pledge. That pledge, made at the time of the last review of the US-Philippines Military Bases Agreement, called for $425 million in military assistance to the Philippines over the five year period from 1985-89. During the first two years of the five year period, Congress has appropriated slightly less than $95 million in military aid, leaving about $330 million for the next three years, if the "best efforts" pledge is to be fulfilled. As we have indicated in the past, this bases-related aid concentrates on providing the most basic mobility, communications, and logistics support to the AFP. These levels of assistance, given the limited resources available from the Government of the Philippines, are not sufficient to rebuild the AFP to a level which would allow it to perform fully its essential missions of internal and external defense. To achieve the goal of building a modern, professional AFP will require more resources.

The second phase involves continuing consultation with Philippine government officials and military leaders in order to determine the extent of AFP needs beyond the basic support provided in the President's request. This consultative process will begin with assessments by the Filipinos themselves. Subsequently, there will be discussions between senior military leaders of both countries to determine military requirements. The next step will involve discussions at higher government levels to integrate military needs with broader policy considerations. After a policy determination has been made, the final step will involve working level meetings between US and Philippine officers to iron out details and establish procedures for implementing our policy. This is a deliberate process, but not a protracted one. Contacts between senior military leaders will begin this month and other discussions will follow shortly.

## KOREA

The Soviet Union certainly poses the greatest threat to US interests in Asia and the Pacific, but it is clearly not the only source of regional instability. Maintaining peace and stability in northeast Asia -- where the interests of the US, Japan, China, and the Soviet Union converge -- is a vital concern of the United States. Renewed conflict on the Korean peninsula would put at risk the stability of the region and the political relationships of the major powers there. For more than 30 years the joint efforts of the US and Republic of Korea (ROK) have deterred North Korean aggression. Our support to the ROK under the Mutual Defense Treaty of 1954 and, in particular, the presence of US ground and air forces in Korea, has played a key role in this deterrence. If deterrence were to fail, these US forces would be engaged immediately alongside ROK forces under the only combined US/allied command outside NATO. Our security assistance goal is a ROK military capability which, when complemented by the US military presence, will deter and effectively defend against an attack by the North.

Despite devoting almost six percent of its GNP to defense, the ROK has been unable to match the massive North Korean military buildup which began in 1970 and continues to this day. The North Korean military now poses as great a threat to the ROK as at any time since the Korean War. The North Korean Army (NKA) is about 40 percent larger than ROK ground forces, with almost twice as many maneuver units, tanks, artillery pieces, and armored personnel carriers. Additionally, the NKA boasts possibly the world's largest special purpose or unconventional warfare force.

Last year I drew your attention to two developments which had a significant impact on the Korean military balance: North Korea's extensive military reorganization and redeployment which included repositioning of ground combat forces nearer the DMZ, and the marked increase in mobility and firepower of North Korean forces. The buildup of the North Korean forces continued in 1985 with the reorganization and redeployment of mechanized and mobile forces. This activity significantly enhanced the North's military posture and caused a reduction in the amount of warning time the South can expect. Improving relations with the USSR brought introduction to the peninsula of new weapon systems for North Korea, including MIG-23 aircraft.

ROK forces continued efforts to redress the imbalance with the North during 1985. The ROK's military capabilities are considerable, but they are also critically dependent on the U.S. for air, naval, and logistics support, warning, and command, control and communications.

The objectives of our security assistance program are to improve ROK air defense capability to counter the North Korean MiG-23's; enhance air defense against low-flying, high performance aircraft; add anti-armor capability to meet the increased North Korean mechanized threat; promote standardization and interoperability of US and ROK forces; and increase Korean war reserve materiel stocks.

Defense spending accounts for approximately one-third of the ROK budget, about $4.8 billion which is almost 6% of GNP. About half of the $9 billion which the ROK will spend for investment during the 1982-86 period will be spent in the United States. This amount -- about $500 million annually over and above the FMS credit allocation -- greatly exceeds in value our assistance for Korea.

Our request for $230 million in security assistance to Korea -- all of it to be in loans at market interest rates -- equates to only five percent of the ROK defense budget. But it is an important five percent. Last year, security assistance for Korea was reduced considerably below our planned levels because of budget constraints. With the Asian Games scheduled this year and elections and the Olympics in 1988, Korea is entering perhaps its most dangerous era in 30 years. We cannot risk a further reduction in support for its defense.

## THAILAND

The United States is committed to the defense of Thailand under the Manila Pact. In the face of the strong military threat which Thailand faces from Vietnamese occupation forces in neighboring Cambodia, we have emphasized our firm and strong commitment to that nation's security and welfare. Unlike Korea, where American military presence is the primary symbol of our commitment, the main symbol for our Southeast Asian front-line ally is our willingness to provide security assistance. Our $108.5 million security assistance program request for Thailand focuses on enhancing the readiness and logistics posture of Thai forces and improving air defense, counterbattery artillery, and anti-armor capabilities.

The pace of Thai force modernization and expansion will depend on the availability of limited Thai resources and US security assistance. An unfavorable balance of trade and increasingly burdensome debt servicing have forced Thailand to impose austerity measures on all branches of the government. Ambitious equipment acquisition plans are being cut back, and in some cases abandoned.

Thailand's independence, integrity and stability are crucial to the overall stability of Southeast Asia. Our security assistance program is intended to help Thailand meet regional threats and defend its borders against Vietnamese aggression. Inadequate security assistance could imperil a staunch ally and undermine the ASEAN strategy for a negotiated solution in Cambodia by calling into question our reliability and sending the wrong signals to Moscow and Hanoi.

Mr. Chairman, security assistance is an indispensible component of our efforts to strengthen our defenses against growing threats to peace and security. In East Asia and the Pacific it is a particularly vital part of our bilateral security relationships with the countries of the region. The levels requested are the minimum support we can prudently provide to the modernization and improvement of recipient countries' armed forces in view of U.S. commitments in the region and the nature of the threats posed by Vietnam, North Korea and the Soviet Union to regional stability and peace.

Mr. Obey. Okay.

Mr. Greenleaf. Mr. Chairman, I just have a brief comment. I have a full statement that I would request to be submitted into the record.

Mr. Chairman, Members of the Subcommittee, thank you for the opportunity to present the Bureau for Asia and Near East budget request for the Philippines and East Asia program assistance for fiscal year 1987.

The budget request for FY-87 includes five bilateral and three regionally-funded programs in the East Asia area. In 1987 we are requesting $108 million in economic support funds, 115 million in development assistance, and $27 million in P.L. 480 Titles I and II.

East Asia is a region with great potential. However, important economic and development problems remain there. The Philippines is one country which will particularly require help from the United States and from other donors as its new government comes to grips with many problems.

AID looks forward to assisting the countries of East Asia under our long-standing commitment to these countries. And I appreciate the opportunity to discuss this budget request with you this morning and look forward to answering any questions.

[The statement follows:]

# EAST ASIA STATEMENT

OF

CHARLES W. GREENLEAF, JR.

ASSISTANT ADMINISTRATOR, BUREAU FOR ASIA AND NEAR EAST

AGENCY FOR INTERNATIONAL DEVELOPMENT

BEFORE THE SUBCOMMITTEE ON FOREIGN OPERATIONS

COMMITTEE ON APPROPRIATIONS

U.S. HOUSE OF REPRESENTATIVES

MARCH 12, 1986

Mr. Chairman and members of the Subcommittee:

Thank you for the opportunity to present the Bureau for Asia and Near East budget request for the Philippine and East Asia programs for FY 1987.

The East Asia region is an area of critical strategic, political, and economic interest to the United States. It is also an area of great development dynamism and potential. Among the foreign policy objectives supported by the programs requested are: assistance to the Filipinos in their economic recovery; and training, financial, and technical assistance to poor people and countries to enable them to improve their incomes and quality of life. The latter objective is accomplished through effective agriculture, health, energy, education, and other development programs.

The budget request for FY 1987 includes five bilateral and three regionally-funded programs in East Asia. In FY 1987, we are requesting $108 million in Economic Support Funds (ESF); $115.4 million in Development Assistance (DA); $15 million in P.L. 480 Title I and $12 million in Title II.

## AID PRIORITIES

The four principal instruments of AID's economic assistance programming continue to be policy dialogue, institution building, technology transfer, and emphasis on the private sector. The programs described in our Congressional Presentation offer many examples of economic policy improvements being pursued by our AID Missions in conjunction with DA, ESF, and P.L. 480 resources, and of projects to create or strengthen local institutions vital to self-sustaining development. I would like, however, to discuss our technology transfer programming, using the child survival effort as an example, and our private sector activities.

### Technology Transfer: The Child Survival Action Program

A major tool for encouraging development is technology transfer, and the Child Survival Action Program (CSAP) offers a particularly good example of its use. After Congress took the initiative, AID established the CSAP in FY 1985 to program additional money under the new Child Survival Fund and other appropriation accounts to promote child survival. Child survival is improved by such services as oral rehydration therapy, which replaces nutrients lost through potentially life-threatening cases of diarrhea; immunizations; nutrition;

and birth-spacing. Technical assistance, training, and support for innovative approaches to service delivery and demand creation are the major means of creating local capacity to use these life-saving technologies.

While several of these activities had been part of primary health care efforts in the ANE Region for several years, the availability of these additional funds enabled us to expand such activities. In FY 1985, the ANE region bilaterally obligated $5.5 million of Child Survival Action Program funds in East Asia, which were supplemented by other child survival initiatives supported with funds previously planned or programmed. Activities supported include:

-- The nationwide commercial production, distribution, and marketing of Oral Rehydration Salts (ORS) in the Philippines;

-- Targeted feeding and growth monitoring programs in Indonesia. These initiatives supplemented already ongoing major diarrheal disease control and immunization programs; and

-- The channeling of central funds to private voluntary organizations working throughout the region.

Within the FY 1986 Child Survival Fund, we have a major new initiative in Indonesia. We also have under consideration expanding the Philippine activity subject to consultation with the Aquino Government.

In addition to the medical technologies being transferred here, social technologies are also being used in support of child survival goals. Particularly in Indonesia and the Philippines, innovative techniques involving the mass media in creating demand for ORS, as well as social marketing for their distribution, are key project elements being employed.

In FY 1987, the ANE Bureau plans to continue its support for multi-year Child Survival activities for projects in Burma, Indonesia and the Philippines.

## Private Enterprise

The Asia and Near East Bureau has made substantial progress in incorporating private enterprise initiatives in our overall program, as a significant means of promoting development in our cooperating countries. We have: (a) begun private sector projects; (b) introduced private sector or market-oriented elements in other projects; and (c) encouraged policy changes which will foster private sector initiatives.

The Bureau has seven active private enterprise projects totalling $93 million in Indonesia, Philippines, Thailand, and the ASEAN region. We are designing two more projects totalling $37 million in Thailand and the South Pacific. We provide technical, marketing, training, and financial support to small- and medium-scale Asian entrepreneurs. Our assistance is channeled through intermediaries such as business associations, government agencies, PVOs and other private organizations, and public and private banks. In addition to such discrete private enterprise projects, we have pursued opportunities to use private mechanisms to accomplish objectives of other sector programs.

## COUNTRY PROGRAMS

### Philippines

The momentous events of the last month have resulted in a reexamination of U.S. economic assistance for the Philippines. Since coming to power, the new Government has publicly stated it places a high priority on economic recovery and reform. All indications are that the new Government intends to move quickly to put together an economic program that emphasizes dismantling of private sector "crony" monopolies, divestiture of public sector corporations, and strengthening the market environment for private entrepreneurs. The Aquino government has organized an excellent economic team with sound business sense and a strong respect for market forces.

The Administration sent a team to the Philippines this week -- headed by the AID Administrator Peter McPherson and comprised of senior Treasury, Defense, and State Department officials -- to acquaint ourselves more fully with the desires of the new Government and to discuss with their new economic team the country's economic situation and prospects. In the course of discussions in Manila the Reagan Administration hopes to begin exploring with the Philippine Government its agenda for structural economic reform. We expect to determine how the United States, in cooperation with other official bilateral and multilateral donors and the private sector, can be most helpful.

It is important, however, that the euphoria which followed the dramatic political changes in the Philippines not mislead us to thinking that the new government's task of reforming the economy will be easy. The economic crisis the Philippines faces, and the policy and structural problems from which the crisis stems, did not change with the change in leadership in

Manila. However, the potential to address these problems satisfactorily has increased since the new Government took power.

The Philippine economy will likely face continued economic decline in 1986, although at a slower rate than in 1985. Most estimates we have seen point to another year of no growth or slightly negative growth. Also, the peso, which had depreciated to about 25 pesos to the dollar late last month, has recovered slightly and is floating at around 21 pesos to the dollar. There are signs of renewed business confidence since the Aquino government took office, but it is too early to assess the impact this will have on the economy in the short or longer run.

The challenge for the Philippines this year will be to implement those policies which will set the stage for economc growth a year from now. The last three years have witnessed a dramatic fall in per capita incomes from around $800 in 1982 to about $600 in 1985. With the population increasing at about a 2.5 percent annual rate, this year will see another decline in incomes and living standards. It is vital that all of our efforts, working bilaterally and in concert with other donors be devoted to reversing this trend, and to laying the basis for long-term sustained growth.

The new Government has indicated its interest in economic reform. Already there have been public statements about dismantling monopolies owned by "cronies" affiliated with the Marcos regime, divesting the public sector of corporate and financial activities which are a drain on the Government's budget, and strengthening market forces, all of which should help restore confidence and investment. This agenda will be an ambitious one to execute and may require substantial donor support. We continue to emphasize a coordinated, multilateral donor approach to helping the Philippine government implement these and other policy changes which are still being identified.

The impact of the change in the Philippine Government on the proposed program for FY 1987 is not yet clear. The Administration's request for FY 1987 is $95 million in Economic Support Funds, $23 million in Development Assistance, and $7.7 million in PL 480 Title II food assistance. These figures still represent the Administration's assessment of what is required for the Philippines, and no changes in it have been made at this time. Our assessment will, of course, continue with the visit of the Administration team to Manila. Meanwhile, our AID Mission in Manila is discussing with the new Government how best to proceed with the current portfolio of Economic Support Fund and Development Assistance projects.

We believe the new government will be interested in retaining many of the valuable technical assistance and training activities in the agricultural, health and energy sectors, as well as selective continuation of research, rural infrastructure and institution-building programs. Decisions on current programs and future initiatives will be reached in consultation with the new government over the next few months. We will consult with Congress when and if new proposals are developed.

Indonesia

Development Assistance in the amount of $55 million, $15 million in PL 480 Title I and $4 million in PL 480 Title II are proposed for Indonesia. The AID program strives to strengthen and diversify food production, improve primary health care and family planning, and expand off-farm employment. To reach these goals the program helps to improve Indonesian technical, management and policy-making skills. These improvements contribute to Indonesia's capacity to adapt new technologies needed to enhance development. AID also encourages the government to decentralize operations and to rely more upon private firms in technology use. The program supports policy analysis relevant to the goals mentioned above through research and demonstration projects and the Mission's policy dialogue with government officials. These goals complement those of Indonesia's current five-year plan, which give priority to investments in agriculture, human resources, energy, industry and rural development.

The goals become increasingly relevant as Indonesia's economic fortunes have become increasingly tied to conditions in the world economy. Of particular concern to the Indonesians is the recent decline in world oil prices, since oil and gas currently account for about 70 percent of the country's exports and two-thirds of budget revenues. Although the outlook for oil prices dominates any projections about the economy, Indonesia's long-term prospects will also be conditioned by the price prospects for other primary commodities, the growth of world trade, and real interest rates. The Indonesian government's structural adjustment efforts have emphasized rapid growth of non-oil exports.

## Thailand

Our request is for $19 million in DA and $5 million in ESF. AID's development assistance strategy for Thailand has changed in consonance with Thailand's development progress. The principal elements of our new strategy support the country's development objectives by assisting in two major areas:

(1) scientific and technological research; and (2) industrial development in rural areas, particularly small- and medium-scale agribusiness. These problems are also expected to be priority concerns addressed in the Thai Five-Year Development Plan for the period 1986-91. In addition, ESF funds are used for the purpose of assisting rural communities affected by refugee inflows and fighting along Thailand's border with Cambodia and Laos.

Thailand is currently in what is generally perceived as a short-term economic slowdown. Real GDP growth in 1985 was no more than 4 percent compared with 6.2 percent in 1984. Agriculture has had great difficulties because of the exceptionally low world prices for the major export commodities. Performance in the industrial sector was decidedly mixed. The debt service ratio has risen to an unprecedented 28 percent which so far has not affected the country's creditworthiness; a plan to refinance up to $700 million worth of debt during 1986 is well under way.

The key issue for Thailand's long term economic well-being will be its ability to increase export earnings, particularly from manufactured goods. The changing focus of AID's strategy in Thailand should help address these problems. The focus of the program has begun to shift from regional poverty to that of accommodating evolutionary changes in Thailand's growth patterns and needs.

Burma

The $10 million DA program in Burma concentrates on the production and processing of selected crops so that Burma becomes less dependent on imports and moves closer to meeting its own domestic food and nutrition requirements, and on primary health care to reduce mortality and morbidity, especially among infants and children. A.I.D. is also supporting the development of human resources through training in the U.S. and third countries, focusing on strengthening Burmese institutional capacity to ensure the sustaining of technological gains and to create a base for future economic development.

Burma is one of the world's ten poorest countries in terms of per capita income, yet it has vast unexploited resources. The import substitution aspect is particularly important in Burma, where economic performance appears to have stagnated during 1985. A deterioriating balance of payments situation (due primarily to decreased rice export earnings, which account for 40 percent of the value of Burma's exports) has resulted in a decline of foreign exchange reserves to a level equivalent to less than one month's imports. Spinoffs of these effects include shortages of capital equipment and investment goods, high rates of unemployment and underemployment, and inadequate and deteriorating infrastructure in almost every sector. A large portion of imports through a parallel economy mitigates this overall negative impact. Nevertheless, these and other serious economic problems portend slower economic growth in the future.

## South Pacific

The regional program for the island nations of the South Pacific is budgeted for $4.5 million DA and $1.5 million ESF. The ESF component is for the second year of a fisheries development assistance program to begin in FY 1986. It is intended to counter Soviet initiatives in the region and to help bring to a successful conclusion negotiations for a regional fisheries agreement between the U.S. and the South Pacific Island nations. The Development Assistance will concentrate on maximizing U.S. development visibility and impact in the agriculture and health sectors, with special attention given to using the mechanisms of private sector involvement and training.

## Fiji

A small program comprising $1.5 million ESF is requested for Fiji. Our program delivers on the President's commitment to Prime Minister Ratu Mara in November 1984 and is intended to maintain Fiji's role as a moderate and influential pro-U.S. force in the South Pacific.

## Regionally Funded Programs

Two additional programs, funded under the ANE Regional account, are targeted at the East Asia region. The first is $5 million in ESF for the Congressionally-authorized program of assistance to the non-Communist Cambodian resistance forces. The framework for this program, which will begin in FY 1986, has now been worked out with the Thai Government. We expect to negotiate the final text of an agreement with the Thai later this month. Only non-lethal assistance will be provided.

The second regional program is $3.9 million DA to support the Association of Southeast Asian Nations (ASEAN) regional development efforts in human resources, energy, marine sciences, environment, and small and medium enterprise development.

## BUREAU MANAGEMENT INITIATIVES

### Reorganization

In May 1985, AID's Bureau for Asia and Bureau for the Near East merged into a single unit, the Asia and Near East Bureau (ANE). The initial job of combining two organizations with different operating systems, program emphases, strengths, problems, and staff has been substantially accomplished.

The reorganization with accompanying staff reductions has increased the need for efficiency measures, such as expanded use of automation, centralization of similar functions, integrated technical support, and added delegations to the field, in order to make the best use of the available workforce.

### Evaluation and Financial Management

The merger of the former Asia and Near East bureaus presented a unique opportunity to bring together the best evaluation features of both bureaus. Central to each bureau was the use of evaluation to support management decision-making. This will continue as a major focus in the ANE Bureau.

With regard to financial management concerns, all Asia and Near East Bureau missions are currently in the process of submitting annual updates to a document describing "Mission Financing Policy and Procedures" to the Washington headquarters. These documents are part of a continuing review process which will ensure that all new project proposals submitted for approval include realistic implementation and financing plans.

The Bureau has conducted "vulnerability assessments" of field missions and also has improved audit liaison procedures. This effort has resulted in a reduction of open audit recommendations during the past year.

## CONCLUSION

East Asia remains a region with great potential. However, important economic and development problems remain. The Philippines is one country which will require much help from the United States and other donors, as its new government comes to grips with many problems.

A.I.D. looks forward to helping the countries of East Asia, which are friendly and strategically important to the United States. Our request for FY 1987 continues our long-standing commitment to these countries. I appreciate the opportunity to discuss this budget request, and I look forward to answering your questions.

## LEVELS OF ASSISTANCE

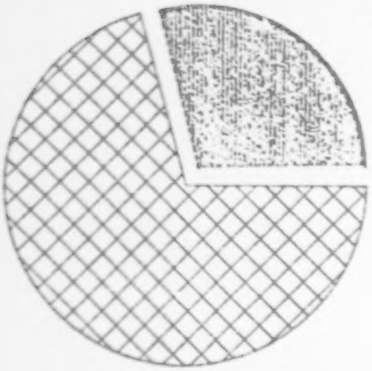
Mr. OBEY. All right. Before we turn to questioning, I just want to get some numbers in the record.

I want to put certified charts in the record at this time.

[Charts follow:]

## GROUND TRANSPORTATION

(Budget Authority)



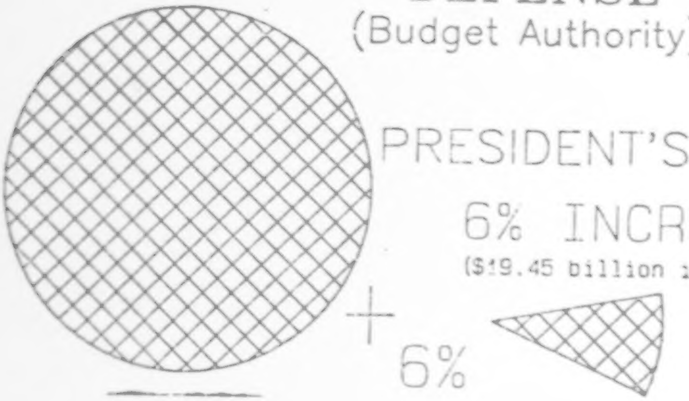
PRESIDENT'S BUDGET

29% CUT

($5.85 billion decrease)

## DEFENSE

(Budget Authority)



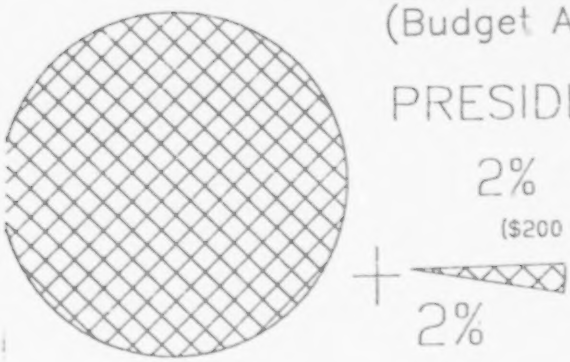
PRESIDENT'S BUDGET

6% INCREASE

($19.45 billion increase)

## GENERAL SCIENCE, SPACE AND TECHNOLOGY

(Budget Authority)



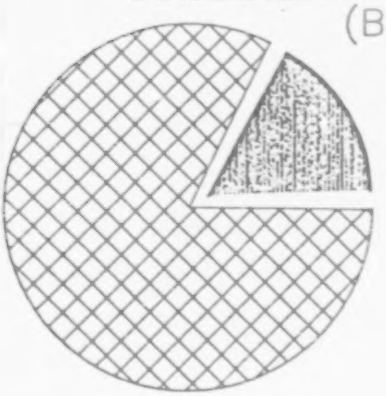
PRESIDENT'S BUDGET

2% INCREASE

($200 million increase)

## TRAINING AND EMPLOYMENT

(Budget Authority)

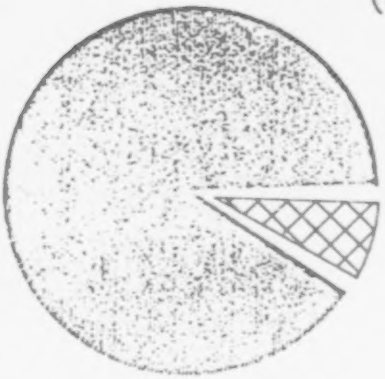


PRESIDENT'S BUDGET

17% CUT

($900 million decrease)

## ENERGY CONSERVATION
(Budget Authority)

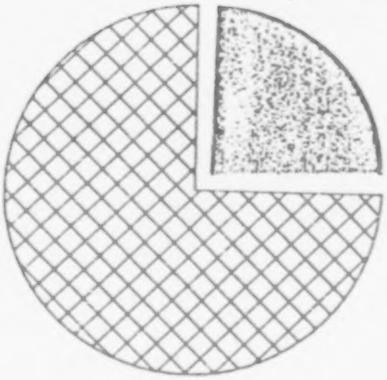


PRESIDENT'S BUDGET

91% CUT

($405 million decrease)

## HIGHER EDUCATION
(Budget Authority)



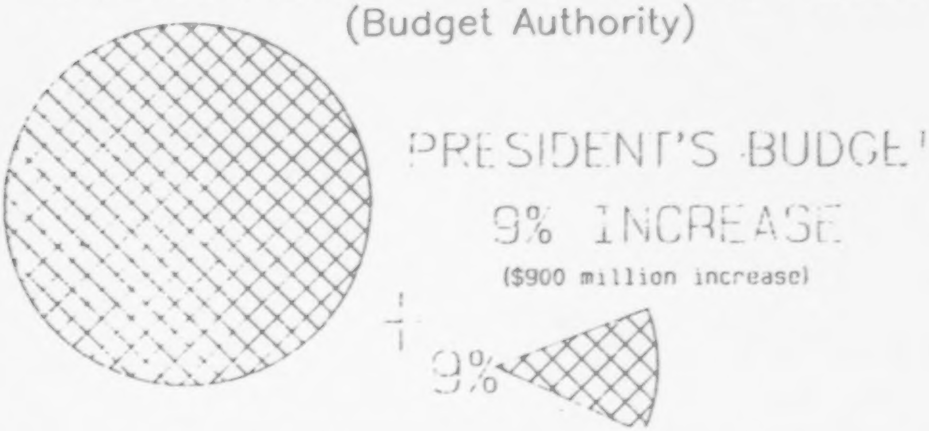
PRESIDENT'S BUDGET

25% CUT

($2.25 billion decrease)

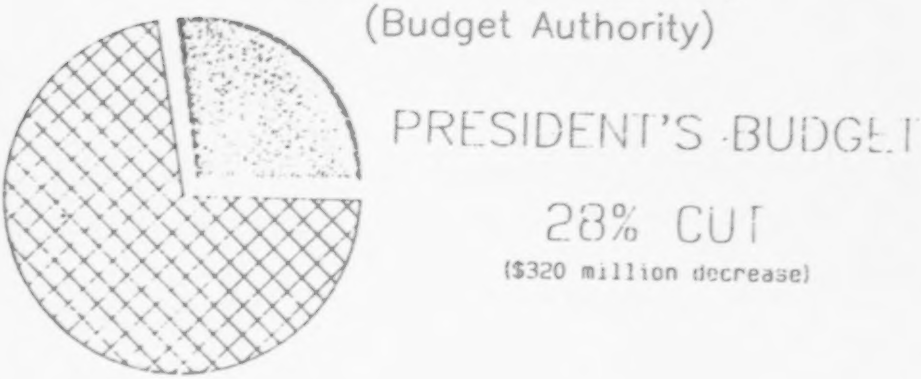
## INTERNATIONAL SECURITY ASSISTANCE

(Budget Authority)

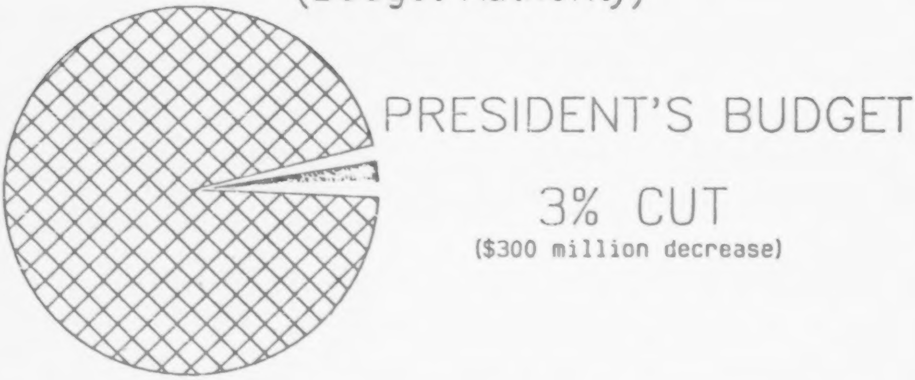


## CONSUMER & OCCUPATIONAL HEALTH & SAFETY

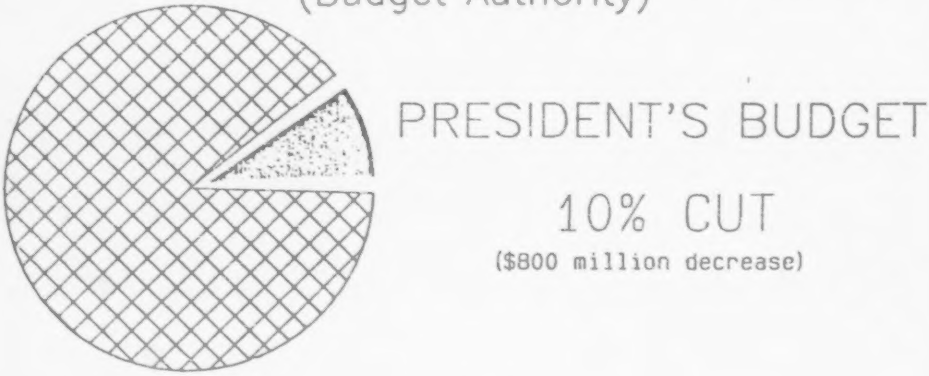
(Budget Authority)



## VETERANS MEDICAL CARE
(Budget Authority)

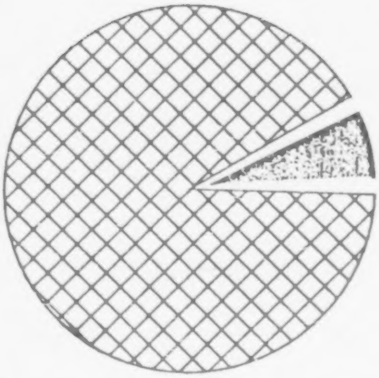


## ELEMENTARY AND SECONDARY EDUCATION
(Budget Authority)



## HEALTH RESEARCH

(Budget Authority)



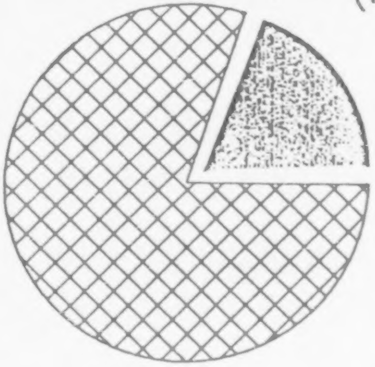
PRESIDENT'S BUDGET

8% CUT

($450 million decrease)

## AGRICULTURAL RESEARCH & SERVICE

(Budget Authority)

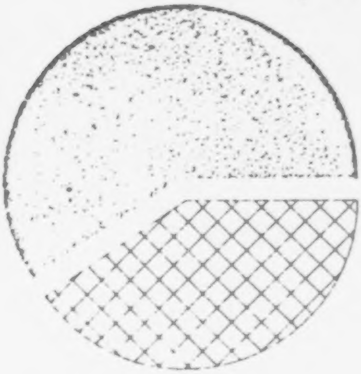


PRESIDENT'S BUDGET

20% CUT

($350 million decrease)

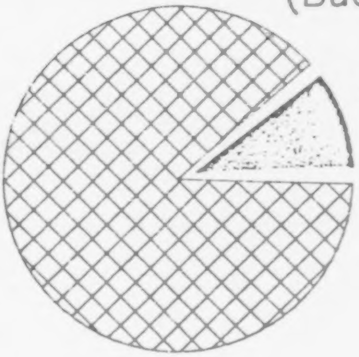
## USDA EXTENSION SERVICE
(Budget Authority)



PRESIDENT'S BUDGET
59% CUT

($205 million decrease)

## COMMODITY CREDIT CORPORATION PRICE SUPPORT PROGRAMS
(Budget Authority)



PRESIDENT'S BUDGET

11% CUT

($2.0 billion decrease) *

## EAST ASIA 1986-87 COMPARISON TABLES

[Dollar amounts in thousands]

| Country | FY 1985 | FY 1986 | Proposed FY 1987 | FY 1986-87 comparison | |
|---|---|---|---|---|---|
| | | | | Dollars | Percent |
| Burma | $20,669 | $15,779 | $20,175 | $4,396 | 28 |
| Cambodia | 0 | 3,350 | 5,000 | 1,650 | 49 |
| Fiji | 2,484 | 3,695 | 3,821 | 126 | 3 |
| Indonesia | 100,574 | 74,014 | 92,800 | 18,786 | 25 |
| Korea | 231,943 | 164,508 | 232,200 | 67,692 | 41 |
| Philippines | 221,884 | 198,171 | 225,964 | 27,793 | 14 |
| Thailand | 140,310 | 117,901 | 142,074 | 24,173 | 21 |
| So. Pac. Reg. | 6,086 | 5,827 | 6,535 | 708 | 12 |
| Total | 723,950 | 583,245 | 728,569 | 145,324 | 25 |

## FAR EAST: DEVELOPMENT ASSISTANCE

[Dollar amounts in thousands]

| Country | FY 1985 | FY 1986 | Proposed FY 1987 | FY 1986-87 comparison | |
|---|---|---|---|---|---|
| | | | | Dollars | Percent |
| Burma | $14,930 | $10,000 | $10,000 | 0 | |
| Cambodia | 0 | 0 | 0 | 0 | |
| Fiji | 0 | 400 | 0 | −$400 | −100.0 |
| Indonesia | 66,265 | 52,960 | 55,000 | 2,040 | 4.0 |
| Philippines | 34,400 | 18,880 | 23,000 | 4,120 | 22.0 |
| Thailand | 24,109 | 19,000 | 19,000 | 0 | |
| South Pacific | 6,023 | 4,500 | 4,500 | 0 | |
| Asean | 4,800 | 3,300 | 3,881 | 581 | 18.0 |
| Total | 150,527 | 109,040 | 115,381 | 6,341 | 5.8 |

## FAR EAST: ECONOMIC SUPPORT FUNDS

[Dollar amounts in thousands]

| Country | FY 1985 | FY 1986 | Proposed FY 1987 | FY 1986-87 comparison | |
|---|---|---|---|---|---|
| | | | | Dollars | Percent |
| Burma | 0 | 0 | 0 | 0 | |
| Cambodia | 0 | $3,350 | $5,000 | $1,650 | 49 |
| Fiji | 0 | 957 | 1,500 | 543 | 57 |
| Philippines | $140,000 | 119,625 | 95,000 | −24,625 | −57 |
| Thailand | 8,000 | 5,000 | 5,000 | 0 | |
| South Pacific | 0 | 957 | 1,500 | 543 | 57 |
| Asia Regional | 0 | 0 | 0 | 0 | |
| Total | 148,000 | 129,889 | 108,000 | −21,889 | −17 |

## FAR EAST: PEACE CORPS

[Dollar amounts in thousands]

| Country | FY 1985 | FY 1986 | Proposed FY 1987 | FY 1986-87 comparison | |
|---|---|---|---|---|---|
| | | | | Dollars | Percent |
| Burma | 0 | 0 | 0 | | 0 |
| Fiji | $2,089 | $1,955 | $1,896 | −$59 | −3.0 |
| Indonesia | 0 | 0 | 0 | | |
| Kiribati | 227 | 145 | 249 | 104 | 71.0 |

## FAR EAST: PEACE CORPS—Continued

[Dollar amounts in thousands]

| Country | FY 1985 | FY 1986 | Proposed FY 1987 | FY 1986-87 comparison | |
|---|---|---|---|---|---|
| | | | | Dollars | Percent |
| Korea | 0 | 0 | 0 | | |
| Malaysia | 0 | 0 | 0 | | |
| Micronesia | 2,361 | 1,778 | 1,716 | −62 | −3.5 |
| Papua NG | 919 | 932 | 918 | −14 | −1.5 |
| Philippines | 5,317 | 4,926 | 5,214 | 288 | 6.0 |
| Soloman Is. | 952 | 801 | 863 | 62 | 8.0 |
| Thailand | 3,179 | 2,784 | 2,804 | 20 | 0.7 |
| Tonga | 601 | 527 | 553 | 26 | 5.0 |
| Tuvalu | 34 | 41 | 43 | 2 | 5.0 |
| Western Samoa | 1,166 | 1,005 | 917 | −88 | −9.0 |
| South Pacific | 63 | 370 | 535 | 165 | 44.5 |
| Total | 16,908 | 15,264 | 15,708 | 444 | 3.0 |

## FAR EAST: ANTI-NARCOTICS ASSISTANCE

[Dollar amounts in thousands]

| Country | FY 1985 | FY 1986 | Proposed FY 1987 | FY 1986-87 comparison | |
|---|---|---|---|---|---|
| | | | | Dollars | Percent |
| Burma | $5,515 | $5,540 | $8,825 | $3,285 | 59.0 |
| Thailand | 2,704 | 3,600 | 4,270 | 670 | 18.5 |
| Asia regional | 275 | [1] 0 | [1] 0 | 0 | |
| Total | 8,494 | 9,140 | 13,095 | 3,955 | 43.0 |

[1] Funding included in Asia/Near East Regional Account.

## FAR EAST: FOREIGN MILITARY SALES

[Dollar amounts in thousands]

| Country | FY 1985 | FY 1986 | Proposed FY 1987 | FY 1986-87 comparison | |
|---|---|---|---|---|---|
| | | | | Dollars | Percent |
| Burma | 0 | 0 | 0 | | |
| Cambodia | 0 | 0 | 0 | | |
| Fiji | 0 | 0 | 0 | | |
| Indonesia | $32,500 | $19,140 | $35,000 | $15,860 | 83.0 |
| Korea | 230,000 | 162,690 | 230,000 | 67,310 | 41.0 |
| Malaysia | 4,000 | 1,914 | 5,000 | 3,086 | 161.0 |
| Philippines | 15,000 | 14,335 | 50,000 | 35,665 | 249.0 |
| Thailand | 95,000 | 80,531 | 103,500 | 22,969 | 28.5 |
| So. Pacific | 0 | 0 | 0 | | |
| Asia regional | 0 | 0 | 0 | | |
| Total | 376,500 | 278,610 | 423,500 | 144,890 | 52.0 |

## FAR EAST: MILITARY ASSISTANCE PROGRAM

[Dollar amounts in thousands]

| Country | FY 1985 | FY 1986 | Proposed FY 1987 | FY 1986-87 comparison | |
|---|---|---|---|---|---|
| | | | | Dollars | Percent |
| Burma | 0 | 0 | $1,000 | $1,000 | 100.0 |
| Cambodia | 0 | 0 | 0 | | |

## FAR EAST: MILITARY ASSISTANCE PROGRAM—Continued

[Dollar amounts in thousands]

| Country | FY 1985 | FY 1986 | Proposed FY 1987 | FY 1986-87 Comparison | |
|---|---|---|---|---|---|
| | | | | Dollars | Percent |
| Fiji | $300 | $287 | 300 | 13 | 4.5 |
| Indonesia | 0 | 0 | 0 | | |
| Korea | 0 | 0 | 0 | | |
| Malaysia | 0 | 0 | 0 | | |
| Philippines | 25,000 | 38,280 | 50,000 | 11,720 | 31.0 |
| Thailand | 5,000 | 4,785 | 5,000 | 215 | 4.4 |
| So. Pacific | 0 | 0 | 0 | | |
| Asia regional | 0 | 0 | 0 | | |
| Total | 30,300 | 43,352 | 56,300 | 12,948 | 30 |

## FAR EAST: MILITARY EDUCATION AND TRAINING

[Dollar amounts in thousands]

| Country | FY 1985 | FY 1986 | Proposed FY 1987 | FY 1986-87 comparison | |
|---|---|---|---|---|---|
| | | | | Dollars | Percent |
| Burma | $224 | $239 | $350 | $111 | 46.0 |
| Cambodia | 0 | 0 | 0 | 0 | |
| Fiji | 95 | 96 | 125 | 29 | 30.0 |
| Indonesia | 1,809 | 1,914 | 2,800 | 886 | 46.0 |
| Korea | 1,943 | 1,818 | 2,200 | 382 | 21.0 |
| Malaysia | 981 | 909 | 1,235 | 326 | 36.0 |
| Papua NG | 52 | 48 | 85 | 37 | 77.0 |
| Philippines | 2,167 | 2,105 | 2,750 | 645 | 31.0 |
| Singapore | 50 | 48 | 75 | 27 | 56.0 |
| Soloman Is | 30 | 29 | 60 | 31 | 106.0 |
| Thailand | 2,318 | 2,201 | 2,500 | 299 | 13.6 |
| Tonga | 47 | 48 | 60 | 12 | 25.0 |
| So. Pacific | 0 | 0 | 0 | 0 | |
| Asia regional | 0 | 0 | 0 | 0 | |
| Total | 9,716 | 9,455 | 12,240 | 2,785 | 29.0 |

Mr. **Obey**. Simply summarizing, what you are asking for under this section of the President's budget is a 25 percent increase overall from the levels from which we were operating under at this time for Development Assistance, you are asking for 5 and a half percent increase, for economic support funds you are asking for 17 percent decrease, but for the military assistance programs you are asking for 30 percent increase. For foreign military sales you are asking for 52 percent increase. For the Peace Corps asking for a 3 percent increase, for anti-narcotics for this region we are asking 43 percent increase.

Just to put in perspective some charts that the Budget Committee passed out this morning in our caucus, we are being asked to take a 29 percent reduction in our domestic ground transportation budget under the President's budget, we are being asked to take for training and employment a 17 percent cut in the President's budget, for energy conservation, we are asked to take a 91 percent reduction in the President's budget from last year, for higher education we are being asked to take a 25 percent reduction, in fact overall there is a 16 percent increase.

Consumer and worker health and safety we are being asked to absorb a 28 percent reduction. Veterans medical care we are being asked to absorb a 3 percent reduction. We are being asked to absorb for elementary and secondary education a 10 percent cut in last year's level. In health research we are being asked to absorb an 8 percent reduction from last year's level. Agricultural research and agricultural services we are being asked to take a 20 percent reduction from last year.

The extension service, which provides information to our own farmers here at home which is similar to agriculture programs within AID, we are being asked to absorb a 59 percent reduction. Commodity credit programs we are being asked to support an 11 percent reduction.

I hope that gives you some idea of why many of the questions and comments which we make will be related not to the substance of your programs, gentlemen, but to whether or not we can afford to fund them given what is happening to other levels. The President's justification for making these reductions is that he is really not opposed to a lot of these programs; he just says we cannot afford them. I guess it is fair to apply that same standard of logic and reason to programs which you are presenting.

And so when I tell you that you are probably going to have to get along with 70, 80 percent less than you got last year, I am not saying that because I enjoy it. I am saying that because in the face of these numbers, we are going to have a devil of a time getting you a dime this year, literally.

Because I often take so much time, let me just turn to other Committee members for their questions before I pursue my own questions.

Jerry, do you want to start?

Mr. LEWIS. Thank you, Mr. Chairman.

### ASSISTANCE TO PHILIPPINES

I am sorry I was late for your introductory remarks, although I did have a chance to peruse your comments before coming. I certainly do not want to sound like a proverbial skunk at a garden party, but there are some questions that do come to mind that I would like to have you respond to and maybe elaborate upon for the record.

When we anticipated a different development in the Philippines, some of us from the President's side of the aisle were heard to say that unless there was strong evidence of a pattern of extended support for democratic processes and expansion of freedom and broader based economic activity in the Philippines, our votes are not going to be a pattern that would expand economic assistance let alone military assistance for that country.

Having said that, we are in a much different circumstance at this moment. But I cannot help but be disturbed by press commentary regarding the prospect of a possible revolutionary government, exercising elements of their constitution that I have doubts about in order to expedite change, suggestions that draw in question, serious question, commitments to fundamentals of democratic processes. I understand that an additional foreign assistance request is in the preparation stage, while it is not here today, we will be hearing more from you.

What kinds of conditions do you anticipate will be a part of those additional requests? Are we concerned about what may be happening to what we view as democratic processes here in the Philippines? What about the forcing of officials at lower level out of office because, quote, they happen to be friends of the past president? Well, do we have concerns about that pattern as this policy goes forward? Do you see tarnish under the glitter of this other side of the Philippine coin?

Mr. MONJO. I had the pleasure of traveling with the Congressmen during the election not so long ago. Indeed it is a different situation that we face today.

As you know, we have Mr. McPherson out there. So obviously our thoughts on that, as the Chairman so rightly said, have to remain a little bit less than fully defined.

To touch on some of the important points that you raised, Mr. Congressman, I think we are hearing a little less now about the revolutionary government. I think at the beginning what they meant by that was they might draw up a new constitution to look like the 1935 constitution which, as you know, is close to ours, a two chamber legislature and so forth.

I think there may be some withdrawing from that. There are a lot of flaws. When one looks at the cabinet, people around Ms. Aquino, they are fairly strong people. Mr. Laurel, who had been one of the strongest supporters of our bases out there, I think you probably all know. You have some prominent business people who are now in the economic ministries. You have the same head of the bank of the Philippines as you had before. These have stayed on. To our bankers he is the number one person we ought to have.

Having said that, we are watching very carefully. What are we going to see in the evolution? Will we have another election? What is going to happen to all the officialdom?

To answer that, I think one must say that except for one or two senior generals who have been in sort of house detention, if you will, there are not the massive arrests; people have not been gone after. Several leaders of the military came with President Marcos to Hawaii.

Mr. LEWIS. Have opted to go home. And have been told, yes, you can go back in your position. Proof of the pudding is in the eating. And I see how that works out in longer term.

I am not really sure who won the vice presidency. It is clear Mr. Laurel was running for it for a long time. I am not sure it is our place to say who did. However, is a legitimate question.

Mr. MONJO. The whole question of what will be the process of constitutionalization, if that is the right word, is very much up in the air. We have heard that the parliament wants to meet to ratify Mrs. Aquino and Mr. Laurel.

The questions you raise are very good ones. But as we watch what is going on, and I think try to share our view on what we think is a constitutional government, I cannot tell you exactly how that is going to work out.

Mr. **Lewis**. I must say that this Member has serious reservations about born again Democrat generals who got their stars during martial law. I think we have got legitimate concerns that are not partisian.

This Member intends to have his vote fall on the side of commitment to expand democray, and freedom and economic opportunity there. And I hope we look at that very carefully. Similar voices were expressed as El Salvador was going through change. And I think that pressure helped. We have got a long way to go, but the struggle has begun.

Having said that, there are additional questions. Their economy is a shambles. Mrs. Aquino has shown great strength, but she is from one of the wealthiest families of the Philippines. I am not sure her natural sensitivity lies with people in the cane fields. But unless that economy turns around, the vacuum is going to extend itself. And our policies as the headlines disappear have to reflect an ongoing concern that was not expressed ten years ago here in these halls and should have been.

### EMPHASIS ON RURAL AND AGRICULTURAL AREAS

Mr. **Greenleaf**. I would like to make an additional comment on your question about the new regime. Looking at the economic scene, Mr. Monjo mentioned the head of the Central Bank is staying on.

Particularly speaking to your last comment, the Minister of Finance, is a successful businessman and someone who has been arguing for years for dismantling the crony capitalist system, and also for emphasizing on agricultural and small scale rural enterprise, which is the heart of the Philippine economic potential, Ongpen has been writing about this, talking about it. I have heard him give speeches, discussed it with him myself, as have others in the Administration.

There are beginnings here which are I think very positive along the lines of emphasizing the rural areas, agricultural aspects, which are the natural point of strength as I said. And I think this also can be said of the others in the economic cabinet.

Mr. **Lewis**. Mr. Chairman, having revealed in a fashion I did not intend to my liberal bias.

Mr. **Obey**. I was stunned.

### MILITARY BASE NEGOTIATIONS

Mr. **Lewis**. I would not the record to go by without my expressing similar concerns for conditions and having the Committee know more about what you are thinking as to what our policy should be vis-a-vis the 1991 military base renegotiations. What kind of communication and progress we are making with this government in that connection. That, of course, is one of the critical links to our being involved and being concerned.

Mr. **Kelly**. I will take that one, Mr. Lewis. The military bases agreement is in fact, indefinite. After 1991, however, either the U.S. or the Philippines, does have the right to terminate, if one year's notice is given.. Now there is a five-year arrangement of base reviews, with the next one to be in 1988.

With the very full plate of problems the Philippines needs a period of time to develop its policies and to determine where they are going. We would not like to not pressure the government of the Philippines on the bases issue to this time. Mrs. Aquino has said a number of things during the campaign. Her later statements in particular did not cause us any serious problem.

We are more interested now in reconstructing the armed forces of the Philippines and having them more capable of meeting the serious problems that they face. Our bases are doing just fine right now, and we will be ready to negotiate seriously with the Philippines in 1988.

Mr. LEWIS. Thank you, Mr. Chairman.

Mr. OBEY. Mr. McHugh.

Mr. MCHUGH. Thank you, Mr. Chairman.

Gentlemen, we are all pleased with the outcome in the Philippines. There are many questions which have to be addressed, and Mr. Lewis has raised several.

### MR. MARCOS IN U.S.

One of the more controversial decisions the President made was to permit Mr. Marcos to come to the United States. I personally support that decision because, among other things, it facilitated his departure and avoided what might have been otherwise a very difficult and bloody situation in the Philippines. So I have no quarrel with his decision.

However, I—and I suspect many other offices—am now getting inquiries, if not protests about what appears to be our Government's support for Mr. Marcos, at least on a temporary basis. I wonder if you could clarify for the record what our Government has undertaken with respect to Mr. Marcos beyond permitting him to live in this country.

Specifically, what costs are we likely to incur? How long is he going to be living at U.S. Government expense? What is the policy of our Government with respect to any property he may have taken from the Philippines?

These are the kinds of questions we are getting from our constituents. I think they are legitimate questions. Perhaps you can make the record clear at this point.

Mr. MONJO. If I might address part of it, I think first of all you made the very proper evaluation at the beginning. At the very crucial moment when all of us were up all night trying to see what we could be doing to be helpful, there was a period where there could have been massive bloodshed, where we could have had a really terrible situation. And I think one must give credit to Mr. Marcos for the fact that attacks were not launched, bloodshed did not take place.

I also credit the public—they acted with restraint, both sides acted to avoid what could have been a terrible moment in the Philippines history in human terms and financial terms. Whatever terms you look at it, it would have been a terrible mistake.

Therefore, I think the offer to Marcos to come here and live in dignity and to bring him out was the right thing to do. I think we can defend that with a great deal of honor, not with any kind of feeling of embarrassment.

As to where he is now, they are hoping to find private quarters. And I think that will eventually transpire. I do not think it is anybody's desire that they remain on the military facility. In regard to the items brought with them, putting aside the personal items, clothing and so forth, as you know the rest is with the Customs Service. Now the future of these things, some of which are being contested by the Philippines government as to who owns what, who owns the documents, who owns the items of value, will be handled through our court system.

That is the case where I think we are happy with our independent court system. And that is the way it is most likely to be handled.

My legal friends, and probably some of your lawyers, feel it may end up in a process where court decides if the items belong to A or B, and the court listens to both sides. I think we are trying to follow two principles, one of dignified reception to the extent it is possible.

I think that is where we stand. I think Jim might deal with some of the other questions.

Mr. KELLY. With respect to the presence of the Marcos party at Hickham and their arrival there, as of about a week ago we had accumulated costs of about $200,000 involved with the air movement of this group from the Malacanang Palace via Clark Air Base, Guam aid on to Hawaii. The expenses of security borne by the Department of Defense have been about $150,000 in labor costs of military personnel that were doing this vis-a-vis their regular jobs.

I am sure there are other costs involved. In fact, this entire effort is one that involves a number of agencies of the federal government. The final question of whose funds are going to pay for these has not yet been resolved. There are also about $87,000 of assorted other costs involved with the upkeep of the party as of about a week ago. Those are the numbers that we have so far.

I think, as Mr. Monjo said, our information is that the party is as anxious to leave Hickam as we are to have them settled in a suitable place. And we hope that this will take place as soon as possible.

Mr. McHUGH. Can we anticipate that after they leave Hickam there will be expenses incurred by the United States Government in their protection?

Mr. MONJO. Marcos himself only was offered Secret Service protection for a period of time. I think the idea was that there would be some until they can get their own set up. While they were on the base, clearly we would not want kooks running in there. We know they are in contact. We did not recommend, but we made available the names of people from appropriate services.

### MARCOS RELATIONSHIP WITH PHILIPPINES

Mr. McHUGH. There are stories, as you know, in the press that Mr. Marcos is calling the Philippines on a regular basis to promote opposition to Mrs. Aquino's government. Is there anything to those stories? Do we have any information on that? Who is paying for the telephone calls?

Mr. Monjo. He calls often, or he and his party call often. Often the calls are charged to people in the Philippines. There have been some costs there. We have been informed by him that he has urged moderation, as he did when he was in the Philippines. I cannot address each individual phone call.

Mr. McHugh. I do not mean to sound petty with respect to these questions, because I think the significance goes beyond the Marcos case. If the United States in appropriate situations is going to be able to offer sanctuary to future leaders in cases where it is in our interest to do so to avoid the kind of bloodshed we could have seen in the Philippines, it is important for the people of our country to understand why that is in our interest and to appreciate that these leaders when they arrive will not be abusing our hospitality.

So I ask the questions I do not only to get specific responses to questions I am getting from my constituents but to put things into perspective. I do think the President made the right decision in the case of Mr. Marcos. And I think the Administration generally handled the situation very well. These of questions, however have implications beyond the Marcos case for potential situations in the future.

Mr. Monjo. Certainly.

Mr. McHugh. I am not sure how much time I have, Mr. Chairman.

Mr. Obey. Go ahead.

### MILITARY ASSISTANCE TO THE PHILIPPINES

Mr. McHugh. If the Administration wants to increase assistance, particularly military assistance, to the Philippines down the road, which may be appropriate, my recollection is that there or some legislative restrictions which were written into the authorization. Is that correct, Mr. Kelly?

Mr. Kelly. Those restrictions do not impede our ability to work now. I think most of the restrictions that you referred to were under consideration for this year's authorization, escrow accounts, and such matters as that. We ended up for fiscal year '86 with $40 million of MAP and $15 million in FMS credits. We are making that available to the armed forces in the Philippines with the kind of control and very close cooperation that we had applied over the last couple of years.

Mr. McHugh. I will go back and take a look at that. You may want to do that as well. I recollect there may have been a cap written into the FY 86-87 authorization bill as to military assistance, which could pose a problem if you want to extend additional military assistance beyond that presently being give. I simply raise the flag to indicate you may want to look at it.

Mr. Kelly. It is something we have to look at very carefully.

Mr. McHugh. If we have to change the cap, it raises a problem with our friends on the authorization committees.

Mr. Kelly. The cap is for FY-86, I believe. That is the $55 million, less the Gramm-Rudman reduction which has been applied. So if we seek additional funds, we expect it would be for FY-87.

## KOREA'S LOAN REPAYMENT

Mr. McHugh. With respect to Korea, you have asked for $230 million in FMS loans. We have had some difficulty for a variety of reasons on repayments. Could you tell me about the status of Korea's loan repayment?

Mr. Kelly. Korea is fully current on their loan repayments. There has not been any arrears situation that I am aware of. They pay their bills on time.

Mr. McHugh. And the request is for commercial rates, as I recall.

Mr. Kelly. Yes, sir.

Mr. McHugh. Not concessional ones. As you know, there have been problems, at least from our perspective, with regard to the Korean Government cracking down on the political opposition. We have our own security interests which underlie our aid to Korea. You have dwelt that as a legitimate and appropriate consideration.

However, there is also a concern that some of us have about the political opposition being oppressed. And that is relevant in terms of the assistance we provide. What steps is the Administration taking to make clear to the Korean Government that we are concerned about the political situation and specifically the limitations placed by the Government on the opposition?

Mr. Monjo. I think the point you make is valid. Unfortunately, if one reads our human rights report, I think it has darker tones to it than it did even a year ago.

I would like to back up just slightly. I personally served in Korea during recent years. I think that the fact that we have a stable security relationship with them—of course we have our troops there and we have assistance we provide, and just the whole web of relationships—makes it easier for us to try to help them move more into opening up their political system.

I do not think it is an either or situation. I think their trusting us makes it easier for us to deal with some of the other problems. That is not to say there are not other problems there. There are. And we have, I think quietly, and in some cases I think in more public statements, tried to give them our strong views about how one deals with the political opposition and how you deal with the press and how you deal with your students and so forth.

You see in Korea remarkably fast economic development, with political development rather bumpily staying behind it. One looks at the history, of course, the history of a country, kings for centuries, tough Japanese Administration for 40 years, and then its 40 years or so of independence marked by a civil war. So one can say that they have a fairly difficult past to go through.

And during all the evolution in this country, you have them facing in the north a very difficult North Korean problem. That is not to excuse it, that is just to note the parameters which they are trying to work in.

Mr. McHugh. We cannot expect perfection, certainly not instantaneously. But it is important for our Government to use its influence and leverage to open up that system. If for no other reason, it makes the country more tolesant. That is in our interest too.

Mr. Monjo. I agree.

## RELATIONSHIP BETWEEN NORTH AND SOUTH KOREA

Mr. McHugh. There have been from time to time tantalizing indications that the North and South might be trying to improve their relationship and reduce the tension. I wonder if you could tell us about the status of those efforts. Is there any hope of improved relations?

Mr. Monjo. There have been discussions in a variety of areas, economic areas. They all seem to get a certain distance and seem to stagnate to some extent. There are points of tension, such as the "88 Olympics". The host wants to be a co-host, which is not even legal under the Olympics rules. They have tried.

At the moment it seems to be more stalemated. But both sides continue to say they want to do that. And we have been very supportive, talked bilaterally, yes.

But one must also be cautious. It was not too long ago that half the South Korean cabinet was killed in Burma, and they missed President Chun by five minutes. So the South acts with caution for good reason.

## IMET FOR SINGAPORE

Mr. McHugh. I have one more question at the moment. It may be more of a comment than a question. I see in your IMET request that Singapore would get a modest increase in IMET training. I have no problem with that substantively, but a question that has come up before is that IMET is provided on a grant basis. If you look at the per capita income in Singapore, it seems to me that it could afford to pay for this training.

There are many countries where it makes sense to provide IMET on a grant basis, but if Singapore can really afford to pay, it would be helpful even though the dollar amounts might be modest in the scheme of things.

Do you have any comment on this?

Mr. Kelly. Mr. McHugh, Singapore pays. We have requested $75,000 for Singapore for IMET. We are spending $48,000 this year. I'll have to get the figure for the record, but Singapore certainly pays 20 times the $48,000.

The reason that Singapore is in the request for IMET dollars, is that an IMET country gets a rate for training which involves essentially the out-of-pocket costs for the U.S. A country that is neither an ally, nor receives IMET funds—and Singapore is not a formal ally—pays a rate which includes amortization of the training plant, for example. Yet we do not establish these schools just to train Singapore or, for that matter, other countries.

So that is the reason Singapore appears there. And I say it is a token amount. But your point is well taken.

Mr. McHugh. Are you telling me Singapore actually pays for considerably more training?

Mr. Kelly. They pay in the millions for training even though we are requesting only $75,000. There are some very substantial programs. Singapore is buying missles, airborne and early warning aircraft, Grumman E-2Cs. And they are going to purchase F-16s. So there is extensive and costly training in the U.S. paid for fully by Singapore.

Mr. McHugh. You should supply that information for the record to put the IMET request for Singapore into perspective.

Mr. Kelly. Be glad to, sir.

Mr. McHugh. Thank you very much.

[The information follows:]

*Question.* How much training did Singapore purchase from the U.S. in FY 85

Answer. The total payment in FY 85 was $1.13 million.

### MARCOS MATERIALISM

Mr. Obey. Gentlemen, on the Philippines, pursuant to all of the stories that have been appearing in the paper about the amount of theft which the Marcos entourage engaged in before they left the country. I know this weekend when I was in my District, the public expressed to me just an incredible outrage at the squalid materialism which was demonstrated by that crowd. I think one Congressman said that Mrs. Marcos made Marie Antoinette look like a bag lady by comparison.

I think that is a pretty good description. Especially when you realize people are dying in the countryside from malnutrition while she was storing up 6,000 pair of shoes.

### PROTECTION FOR MARCOS

I guess my question is this: obviously we are happy Mr. Marcos is gone, and we understand that we had to help facilitate his leaving. But as a number of people have asked, the question in a lot of people's minds is how much the United States Government feels obliged to protect in addition to providing Mr. Marcos with a place to live? What kind of assurances?

Can you tell us anything about the kind of assurances that were provided Mr. Marcos that would go beyond merely allowing him to relocate in this country?

Mr. Monjo. Basically my understanding, sir, is the assurance was you can come here and live. And he was paroled, which is something that is an indefinite status if you will, or can be in definite status. And I think the other comment was there would be medical facilities available, there are obviously some medical facilities in this country.

As Mr. Kelly said, the expenses are a question to be resolved. But when they leave the base to find private quarters and at the appropriate time get their own security detail, which I think is a wise idea, they will then basically be on their own.

Now, we have lots of questions about—I am not a lawyer—what special status or whatever might a person have? Someone who lives in our country does not have the same special status that he may have in his own country unless he is a registered diplomat.

### MARCOS' ASSETS

Mr. Obey. My question is more related to whether or not Mr. Marcos was given any assurances whatsoever in terms of what he would be able to take out of the country, the kind of assistance we might or might not provide him in order to keep what he had stolen before and during his departure?

Mr. MONJO. My understanding was they were offered transportation for themselves and a group, which turned out to be about 90 people, and baggage. You will appreciate, sir, that it was a very tense time, moving quickly. And as you can see, the contents of the second plane have been impounded and are going through Customs process and may end up in the Courts.

So I cannot say exactly what were the intentions of those who made the various arrangements. It was a very fast moving situation. As you know, he left in the dark.

Mr. OBEY. But can you give us some idea of what assurances were made, if any?

Mr. MONJO. My understanding was the assurance of being permitted to live here, no time limit, and to be able to come here. I am not sure that there was a specific discussion of baggage or anything else.

Mr. OBEY. What about for getting what they brought? Let me put it this way: did Marcos or anyone negotiating with him during discussions with anyone in the Administration request any assurances from any Americans with whom you talked, about the ability to retain accumulated assets of any kind?

Mr. MONJO. I am not aware of any, Mr. Chairman. And if you look to see——

Mr. OBEY. Who would be? Who could we——

Mr. MONJO. I think there were none. I am saying I am not aware of any. I was not present at any conversation. I can say officially there were none that I am at all aware of, official requests or answers.

What took place in the conversation in the sort of excitement of the departure, I could not vouch for. But I think one must see what is happening. You see lawsuits in New York City about the ownership of an apartment building. You do not see anything suggesting that the Executive Branch is standing back.

Mr. OBEY. I know in various meetings I was in with various Administration officials during that time, in fact one the day before, I remember a number of times the point was made to us by various Administration spokesmen that we want Mr. Marcos to be able to leave with dignity at this time, and if he moves here, we do not want him to be hounded.

We do not want him to be hounded either, but the question we have to ask, given our responsibilities here, is that in our concern for avoiding that he be hounded in return for his leaving the country, did they request any kind of assurances? Or did we provide any? And I guess what I would ask you to do is, in addition to the assurances you have given us this this morning, if you can give us a more definitive response in writing.

Mr. MONJO. Yes, sir.

[The information follows:]

### U.S. GOVERNMENT ASSURANCES TO FORMER PRESIDENT MARCOS

The U.S. government conveyed to former Philippine President Marcos the following assurances prior to his departure from the Philippines:

That he was welcome to come to the U.S. to live and to remain as long as he wished:

That he would have access to medical treatment, if he desired.

In addition, the U.S. Government offered transportation to the U.S. for former President Marcos and his family, as well as for several close advisors, household staff and security personnel.

These assurances were offered in the context of the crisis in the Philippines and were aimed at the achievement of the U.S. policy objective of assisting in the early and peaceful resolution of that crisis.

### U.S. ASSISTANCE TO MARCOS GOVERNMENT PRIOR TO ELECTION

Mr. OBEY. Okay. Is it true that prior to the election AID helped shore up the value of the Peso in the Philippines by purchasing a large number of Pesos using U.S. dollars?

Mr. GREENLEAF. Well, we have disbursements of our ongoing program, Congressman. And we have certain commitments on an annual basis. There was in December a disbursement of $45 million. As you know, the disbursement process involves our giving them dollars, thereby generating Peso which fund mutually agreed on activities. One disbursement in December was based on the needs that had come into play at that time.

Mr. OBEY. How does that compare with the previous four or five Decembers?

Mr. GREENLEAF. Well, actually we had several of the previous falls, I think the prior year, I believe it was in October, we had a distribution of funds. There was no connection whatsoever to the election or any of the political activities there.

Mr. OBEY. You are saying in December it was $45 million that was converted?

Mr. GREENLEAF. Right. This in fact was the $45 million that you recall in——

Mr. OBEY. This is ESF money?

Mr. GREENLEAF. ESF. We received extra money beyond what we asked for. Congress gave us $45 million beyond what we asked for in FY 1986. We committed this amount as a program grant to the Philippine Government to assist them with what would be their share for funding the projects that the World Bank and Asian Development Bank and ourselves would support.

Mr. OBEY. Do you know what happened to those Pesos?

Mr. GREENLEAF. We followed the Pesos. In this case the Pesos went into the Philippine treasury—the dollar went into the Philippine treasury. From there, the Pesos specifically went to previously designated projects that were, as I said, agreed upon by the Philippine Government and the World Bank, and the Philippine Government and the Asian Development Bank and ourselves.

The grant addressed a problem that had arisen because, due to the downturn of the Philippine economy, the Philippine Government had not been able to provide their share of local currency support for donor projects. So we had elaborate discussions with the Philippine Government as to which projects were okay to use this money for. And that was indeed designated.

I am sure I can give you more detail as to which projects were identified.

[CLERK'S NOTE.—The information follows:]

The $45 million (853,785,000 pesos) is currently being held in a Government of the Philippines (GOP) Bureau of Treasury (BTR) non-interest bearing special account with the Central Bank of the Philippines.

Authority to manage the special account is vested in the BTR while releases therefrom are covered by Office of Budget and Management (OBM) issuance of advises of allotment (obligation authority) and cash disbursement ceilings (disbursement thority). Once funds are transferred to the GOP General Fund, the ESF Secretariat manages the DSP Program, monitors implementation and reports on program progress.

The transfer of funds from the special account to the GOP general fund is not yet affected because the Condition Precedent (CP) under Article 6 of the Development Support Program (DSP) Grant Agreement has not been met by the GOP. The CP pertains to OBM certification that advises of allotment in the total amount of the DSP budget have been issued with respect to the projects included in the DSP. Therefore, amounts designated and applied for each project still have to be determined.

The projects against which the local currency will evenutally be applied are IBRD, USAID and ADB projects. These include:

IBRD

Vocational Training Project
Central Visayas Regional Project
Agricultural Support Services
National Fisheries Development
Fishery Training
Seventh Education Sector
Population Project II
First Rural Water Supply and Sanitation
Small and Medium Industries Development
Rural Roads Improvement Project
Rainfed Agricultural Development
Philippine Petroleum Exploration Promotion
Watershed Management and Erosion Control
Samar Integrated
Fifth Highways
Eastern Samar Road
Regional Cities Development

USAID

Primary Health Care
Rainfed Resources Development
Eastern Visayas Training System
Barangay Water Project
Population Project III
Small and Medium Enterprise
Non-conventional Energy Resources

ADB

Second Laguna De Bay Irrieation
Philippine Forestry Development
Palawan Integrated Area Development
Philippine Aquaculture Development
Technical and Vocational Education
Third Road Improvement
BRCIADP-Lake Bato Watershed
Smallholder Livestock Development
Agusan II
Davao III
Allah River Irrigation
Bukidnon Irrigation
Luzon Roads
Mindanao Secondary and Feeder Roads
Second ADB Roads

Mr. **Obey**. We are sure that is where all of those Pesos are now?

Mr. **Greenleaf**. That was the designated purpose. And in fact the reason it did not come any sooner than that is because of the economic problems they were having, they really had not focused what they should have on what the projects were that were the meritorious projects.

Mr. **Obey**. Do we have a list of those?

Mr. **Greenleaf**. Not right here.

Mr. **Obey**. I mean for the record. In light of the incredible ripoff which the Marcos entourage engaged in, and in light of the fact that there had been rampant corruption and skimming in that government for as long as I have been old enough to read, my question is given the fact that a number of people who were in important positions under Mr. Marcos are still in important positions under Mrs. Aquino, my question I guess is what steps are we going to take to make certain that we do not run into the same problem under whoever is running the show now?

Mr. **Greenleaf**. Let me comment. I believe Mr. Monjo mentioned earlier that the Governor of the Central Bank had stayed on. That was reviewed by us and out bankers as a very positive development. The Governor of the Central Bank has been a very important element in the reform efforts that have been going on. And he is in fact, to my knowledge, one of the significant figures that we will be dealing with.

Mr. **Obey**. I think that is more on the military side.

Mr. **Greenleaf**. The ministry of human settlements, which you know was involved in implementing the AID ESF program has been dissolved. And until a couple of days ago the national economic development authority which handled the AID program did not have a head.

Mr. **Obey**. If that has been dissolved, how would ESF money——

Mr. **Greenleaf**. That is something our team out there and mission will obviously ascertain. There will obviously be a different situation for dealing with that. We feel though that the process that we have gone through on ESF, which has been meticulously administered and carefully audited by both GAO and our own Inspector General, is a solid system. The actual system of managing the money, I think that continues to be as careful as it was before. In fact, we have 17 people involved in just keeping track of where the various projects were, both direct hire people as well as contractors. And we are doing this on a full-time basis.

### MILITARY PROCUREMENT

Mr. **Obey**. Do you expect General Ramos to change the military procurement system in any way in order to reduce corruption? Will the joint military advisory system be able to monitor U.S. AID more closely under the new team?

Mr. **Kelly**. Mr. Chairman, I think that General Ramos is going to try to upgrade the military procurement system. I think our military advisory group will be able to continue monitoring that.

Since early '84, we have put very stringent controls on our military assistance. We realized that if we were to have any credibility with the Congress, that our assistance had to be clean. The GAO has correctly pointed out subsequently some problems that had existed earlier.

However, since 1984, all of the military assistance was provided only by government to government agreement, in which the contracts are awarded only by U.S contracting organizations. Meanwhile, in the Philippines, Defense Minister Enrile has remained Minister of Defense and General Ramos has become Chief of Staff.

We do have, however, new personnel handling fiscal matters. We have one of the most respected figures in the Philippines, retired General Raphael Ileto, who has been for many years Philippine Ambassador to Bangkok. He was more in exile than part of the government. He has returned to be Deputy Minister of Defense. We have more new officers holding senior positions. And we have the reform movement as a watchdog on the entire process, in addition to our own small staff.

So we have good confidence that the problems of the past need not occur again. We fully recognize that such a possibility could occur, even with a new, cleaner government, but we believe that our procedures are adequate, certainly in the case of U.S. assistance.

### MAP FOR PHILIPPINES

Mr. Obey. As you know, there has been a great deal of discussion about whether the change in the Philippine government will lead to policies that will require military assistance to combat the Communist rebels. Is it true that at least $20 million in prior MAP funds have been available for the Philippines but have been held up because there has been no agreement between them and the U.S. about how to use them?

Mr. Kelly. The current year MAP dollars were just released in January. Because of the extreme confusion that existed in Manila, those funds have not been spent. There was not a substantial amount of prior year MAP money. There are some unused credits, but the fiscal position in the Philippines was such that they really could not borrow any more.

But there is not a large backlog of unspent money other than what I mentioned. The new Armed Forces of the Philippines are going to be looking at their new requirements, and that money will be available to them.

Mr. Obey. I know conditions have changed. But nonetheless, your budget recommends $5 million for MAP and $50 million for concessional financing, more than doubling the amount available. I know we are all enthusiastic about the new government, but would we not be better advised to be more cautious before we commit additional money on the military side, until we know exactly what shape that operation is going to be in in terms of the tightness of it and whether or not they are going to be able to actually effectively move to control what is happening in the countryside?

Mr. Kelly. I think there are two aspects of that. First, of course, the funds we are requesting now will only be available after the 1st of October for FY-87. The second element is that they are re-establishing, and re-organizing the armed forces. At the same time, the Communist insurgency is estimated to include close to 20,000 full-time armed insurgents, clearly, a sizable number of these people will not leave the insurgency, and it will remain.

But I think at the moment both the government and the insurgents are looking each other over. This provides some time. That is why we do not envision any additional requests for FY-86.

We will just have to see how it develops in FY-87. We do, of course, have the five-year "best efforts" pledge before us. And this is still well short of that.

Mr. OBEY. If they are having trouble using past FMS funds, why should we use financing to gin up assistance we provide——

Mr. KELLY. The requirements, Mr. Chairman, are enormous. In the Philippines there was a confused situation, particularly during January of this year, that bordered on revolution. Moreover the appropriate officials simply were not available to sign the documents. The requirements of the AFP for logistics help, for communications, for mobility, were and are very major, far beyond the requested assistance.

This is a country that has been spending only about 1 percent of GNP on its military forces. The money that comes from the Philippines budget essentially has paid salaries and subsistence, and sometimes not even that, with nothing left for investment in equipment.

So that is something that must be worked on, first by the Filipinos and then from our resources. We have a solid list of items to back up our request for FY-87. We believe that they will be needed, but we are anxious for the Filipinos to reaffirm the validity of that list themselves.

We expect they will reaffirm that validity in the consultations that are occuring now and over the next couple of months.

### LAND REFORM

Mr. OBEY. Let me ask on the question of land reform, even Mr. Marcos in somewhat of a national jolt I guess, indicated his willingness to be measured by how effectively they pursued land reform. In fact, I was having a conversation just the other day with a member who spent considerable time in the Philippines during the past and said, "Look, the new government is certainly terrific in comparison to the old standard," but he said, "you know, basically if you lock at the complexion of that government, it is still a fairly upper-class collection of people." He also said "I really doubt that there is going to be a significant commitment on the part of this new bunch to the kind of land reform which is going to be necessary, along with a lot of other things obviously, like enforcement of the law, which is going to be necessary to win the hearts and minds of the peasantry."

And I guess my question is: what kind of a read do we get on this new government's intention to proceed with land reform so that you do not have some outrageous disparities in living conditions between the plantation owners and 90 percent of the people in those areas? And what kind of advice are we giving them? And what kind of a read are they going to get on us in terms of our insistence that they move forward strongly with land reform?

Mr. **Greenleaf**. No 1, what you alluded to about the government's interest in land reform, this will undoubtedly be one of the topics being discussed this week. We hoped it would be. We are certainly interested in helping in this area.

As you may know, AID was involved with Philippine land reform in the seventies, which did have some accomplishments. We got out of supporting the program in the latter part of the seventies when it appeared it was not going to go any farther for various legal reasons.

We would be interested in hearing the government's ideas on a land reform program to determine if there is room for A.I.D. participation.

And second, the Administration does appear to have land reform on its future agenda in some form.

Mr. **Monjo**. They had made a couple of strong statements while Marcos was still in, knocked off their 11 big showcase projects. It seems to me they are oriented.

The question you raised, Mr. Chairman, will this group of rather privileged people be able to empathize enough and understand enough, I think the first signals are that they do understand. Only time I guess will tell what their programs will do. You look at some of the people, like all the sugar farmers, they probably should not have that many sugar farmers. It cost $.12 a bushel to grow sugar and it cost $.04 in the market.

## PHILIPPINES ARMED FORCES

Mr. **Obey**. There have been reports that DOD is discussing an option to deploy up to 300 U.S. special forces personnel to the Philippines to assist the Philippine armed forces. Is there any truth to that?

Mr. **Kelly**. There is essentially no truth to that. I think, at most, that represented some planning options only being discussed by some low ranking officers within the U.S. Government. The question was taken from the article that appeared in "Newsweek." And our response in the past has been that the Filipinos are going to have to deal with their own insurgency' It is not going to be Americans that can or will fight it for them. Training is an important part of our programs, but we have no plans to send 300 special forces.

Mr. **Obey**. What about advisers?

Mr. **Kelly**. Or, for that matter, 300 advisors, and none have been provided.

Mr. **Obey**. I have other questions on that point that I can insert in the record at this point. And if you would respond to them, I would appreciate it.

[Questions and answers for the record follow:]

### The Philippines: Role for U.S. Special Forces?

*Question*. Recently there have been reports that DOD is discussing an option of deploying up to 300 U.S. Special Forces personnel to the Philippines to assist the Philippine Armed Forces. Supposedly they would be "advisors" but would not be involved in combat. Does the advisory role trigger the reporting requirements of the War Powers Resolution?

Answer. There are no plans to assign U.S. Special Forces as advisors to the Philippines under active consideration within the interagency policy community. Therefore, the question of the War Powers Resolution's applicability to the current situation in the Philippines does not pertain.

*Question.* Is there any indication that the new Philippine Government is interested in this type of U.S. military aid?

Answer. President Aquino's Government has not expressed an interest in this kind of advisory assistance.

*Question.* Would funds for this operation come out of military assistance funds or from DOD appropriations? What are the estimated costs?

Answer. Since there are no plans for such an operation there are no funding requirements or estimated costs.

As a general rule, however, aid of this type would be financed by security assistance funds.

*Question.* To date there have been few incidents in which the insurgents have interfered with U.S. bases or military operations. If U.S. personnel become directly involved in the anti-insurgency program, how will that affect the rebel actions toward our bases and personnel?

Answer. There are no plans to have U.S. personnel become directly involved in the anti-insurgency program of the Philippine Government.

### CAMBODIAN RESISTANCE FIGHTERS

Mr. **Obey**. Last year Congress provided 5 million bucks to be available to the Cambodian resistance fighters. The Administration's report on how those funds would be distributed by country in your report submitted February 1st showed that the plan for '86 was to spend only $3,350,000, whereas under the Gramm-Rudman formula, the account would have been only cut to $4,784,000. Why did the Administration choose to take a larger reduction on that?

Mr. **Monjo**. Sir, if my memory serves me correctly, an authorization was made and we supported it. We thought it gave the right signal. But that did not increase the pie from which we were cutting. So you had in effect something we, both the Hill and Executive Branch, desired. But there was no extra——

Mr. **Obey**. So it was a budget choice, not a policy choice?

Mr. **Monjo**. Yes, sir. It was really squeezing out money.

Mr. **Obey**. Do you have any other questions at this point?

### CAMBODIAN SITUATION

Mr. **McHugh**. While we are on the Cambodian issue, Mr. Chairman, it would be helpful to have an update on the status of the situation in Cambodia. As I recall, the Secretary when he testified indicated there were as many as 9,000 resistance forces in Cambodia. That sounds fairly impressive. He indicated as well that more were expected.

I wonder if you could elaborate on that and tell us what the situation is at this point, what we might expect.

Mr. **Kelly**. I will go through it very briefly, Mr. McHugh. After the Vietnamese invasion of 1979, a coalition of resistance fighters was organized. Two elements of that coalition are non-communist; one under Norodom Sihanouk and the other under Prime Minister Son Sann. Their efforts are supported by the U.S.

The third element of that resistance is the communist Khmer Rouge. The Khmer Rouge constitutes about 30,000 resistance fighters. There are considerably fewer troops in the non-communist resistance. Probably in the vicinity of 5 to 20,000.

Of these three pools of resistance fighters, a number—and I certainly would not quarrel with the Secretary's 9,000—are inside Cambodia being opposed by the Heng Samrin Army and by some 140,000 Vietnamese troops as well. This constitutes an insurgency inside Cambodia, and it is going on.

The accounts that come from Cambodia are very shadowy. People will report that they saw some warehouses burned in place X or burned out fuel tanks in place Y, or that roads have been closed off. It is all pretty sketchy.

And I do not think anyone suggests that the resistance is going to overthrow the government rapidly.

With that, maybe Mr. Monjo has something to add.

Mr. McHugh. I presume it is fair to say that our policy goal is to prevent the Vietnamese government and its allies in Cambodia from consolidating control; is that right? Is there any prospect of overthrowing the government there?

Mr. Monjo. I think you have given the first half of the policy goal. The second half is for the Vietnamese to find it rather expensive and endless. The Khmer do not ethnically have any closeness to the Vietnamese.

If they find that this is an endless headache, one day they may find it is better to go to the conference table. They are rather isolated in the world. No one lends them any money. Their economy is going nowhere, 140,000 troops in Cambodia. After taking money from the Soviet Union, they may not like that dependency.

If the freedom fighters keep up that situation, that degree of discomfort, and the Vietnamese realize that it is not going to be easy, then you have more chances.

You are correct. We do not expect to see the taking over of Phnom Penh by force.

Mr. McHugh. Have we actually expended the money appropriated yet? Has it been obligated?

Mr. Greenleaf. No, we have not, Congressman. We have had discussions with the Thai. And some of my colleagues from the AID have been out there. And we are working out the framework.

### NATURE OF ASSISTANCE

Mr. McHugh. What is the nature of the assistance we expect to provide?

Mr. Greenleaf. Well, the legislation that we are operating under asks that we provide assistance to the non-Communist resistance forces. So AID would provide nonlethal assistance. But at this point we have not really gone to the table yet. And that is still being discussed.

Mr. McHugh. Thank you, Mr. Chairman.

### THAILAND'S FOREIGN AFFAIRS PROGRAM

Mr. Obey. I have a number of questions on Thailand I would like to ask you for the record. Let me ask you one here. Do you think Thailand can actually afford $100 million a year foreign military sales program?

Mr. Kelly. Yes, sir. But it is clearly a strain on the Thai economy. Yet, their security needs are quite substantial. They face directly Vietnamese troops on the Cambodian border. Vietnamese and Thai troops confronting each other is not something that anyone in Thailand views very favorably.

There have been and continue to be incursions by the Vietnamese into Thailand.

Now, the economic problems of the Thais are somewhat worse than they were. And that is why some $5 million of our request is for grant funds and a sizable share of the rest is for concessionary credits, because there are some limits on Thai ability to continue to borrow at Treasury rate.

### AID TO INDONESIA

Mr. OBEY. Indonesia, the Administration is asking that U.S. aid be increased by 25 percent, from $75 to $93 million. The increase is mainly on the military side with concessional FMS funds nearly doubling from 1986, with development assistance going up only 2 million bucks. Based on the overwhelming social needs in Indonesia, how do we justify doubling their military program while essentially leaving development assistance at existing levels?

Mr. KELLY. Partly, sir, because our development assistance has been maintained at a plane across several years. This requested level would go back to the more accustomed level. We had, for example, $32.5 million in FMS credits for FY '85. The reasons for going to 19 million in FY-86 were partly budgetary, and also because some larger programs of the Indonesians were not expected to come on stream until later on.

Indonesia is a very large country, which sits astride three critical strategic choke points. There are a certain number of military needs there, particularly in the purchase of modern aircraft, which this aid will partially go to assist.

Mr. OBEY. What bothers me about this is that, as you know, the Senate made an effort last year—or tried to at least—the Senate Subcommittee made an effort last year to try to provide an interest rate buydown for Israel. That failed. It was withdrawn because I think the Committee recognized that this was not the right time to suggest anything like that.

But in the context of the discussion on that issue, we received a whole laundry list of countries who were in trouble in terms of their ability to eventually buy back what they had been borrowing.

And if I look at Indonesia's situation, I would not put them on the top of anybody's list in terms of their ability to pay back these funds in the long term. Not that I necessarily put them at the bottom either. But I mean that is a big load for them to carry.

Are we really doing these countries a favor when we continue this pretense that somehow we expect them under the terms and conditions of our credit programs one day to pay us back?

Mr. KELLY. We do expect Indonesia to pay. And they are paying. We expect them to pay $51 million in FY-86 on loans and credits that go back quite a few years. I think the number here is about $34 million in principal payments alone at a time that their oil revenues have very sharply dropped.

This provides us some problems. But our experience has been—and Mr. Monjo I am sure has something to add to this—that the management of the Indonesian debt has been most responsible in recent years.

Mr. OBEY. I am not suggesting it has not been. But my point is given what has happened in oil prices, things are changing a lot. And what I am talking about is not what they have been able to do up to now but what is the situation going to look like five years down the line. I just have great concerns that we are not really doing any long-term favors for these sort of things.

Mr. KELLY. That is why our request for FY-87 is at a concessional rate, given the size of Indonesia and low per capita GDP.

Mr. OBEY. Meanwhile, what are we going to do with those concessional loans to farmers and students who we are clobbering in our country? I recognize the substantive point you are making, but I have to deal in the real world of how to get the votes for this turkey. And it is going to be pretty tough.

### KOREA

Korea, how many Americans died in Korea?

Mr. KELLY. I would say about 50,000, sir. I would have to get—no, it is more than that. I would have to get the number for the record. It was a very substantial number, 50 to 53 thousand.

[The information follows:]

*Question.* How many American service personnel were killed in the Korean War?
Answer. A total of 54,260 were killed.

Mr. OBEY. What did we fight for in Korea?

Mr. MONJO. We fought to assist them to resist. They were fighting themselves. We were fighting with people, not by ourselves.

Mr. KELLY. Well, this was the subject of a big debate in the fifties on what constituted victory.

Mr. OBEY. That is not my question. I know the whole debate on that subject. My point is I remember at the time we were under the impression we were fighting for freedom and democracy. We were fighting against anti-democratic forces.

Now, we have got a government in South Korea. And admittedly the government in North Korea is worse, but the government in South Korea muscles their opposition, confines them to their homes, does not permit full participation by any means in activities Americans take for granted. They muscle members of Congress when they go over to that country, participating along with some other Korean politicians in an effort to assure safety of some people.

Our Ambassador then rationalizes and virtually defends the Korean conduct, at least in his first public statement before he backed off. After the money and all of the blood that we have poured into that country, it seems to me we are not getting very much out of it.

And I just want to read something that Congressman George Brown stated on the floor just last week. He said:

> Communism would wither on the vine if the world could again look to America for leadership and support of an authentic revolution. We supported too long tyranny in Cuba and we got Castro. We supported too long tyranny in Nicaragua and we got Ortega. And in the prior years we supported too long the tyranny of Portugal and Africa and got the Marxist government of Mozambique.

I would add that we looked with horror on Mossadegh in Iran in the fifties and rushed to impose the Shah in that country. And we wound up getting the Ayatollah. And in Korea I am not at all convinced that it is any different.

And what I am wondering is what shape are we going to be in when things in Korea eventually become too disgusting for the citizens of that country to take? We were not justified in our prolonged support for Marcos far beyond the support I think we should have provided him on the grounds that we were protecting those bases. And what we really did was to risk the loss of those bases long-term if we had stuck with him longer than we did, very understandable concerns.

We justify AID support for South Korea on the grounds that North Korea is belligerent and unpredictable and obviously had aggressive tendancies in the past. But as you indicated, our AID is only about 5 percent of that military budget. If that is the case, what do we really get in terms of anything that makes a difference? Do we really get something that is worth our identification with the kind of government that we have in South Korea?

Mr. MONJO. Well, I think our identification is pretty firm. We have got 40,000 troops there. I would not think the identification with the government but the whole people. Especially when President Chun steps down in '88, as he continually promises, we will deal with the government in the future.

I would say in South Korea you have many problems, but you also have hope. Anyone who is going to North Korea paints about as weak a picture as one can imagine. They spend about 25 percent of GNP on defense and seem to be endlessly poised to attack their southern neighbor.

### HUMAN RIGHTS IN KOREA

Mr. OBEY. What are we doing? The question is not whether they are nicer than the North Koreans. The question is what are we really doing on a hard nose basis to tell these birds that we do not want to be identified with their kind of human rights abuses any more than we want to be identified with Marcos'?

Mr. MONJO. We note abuses publicly in our human rights report. We also talk privately to try to influence people. Because of the newness of their democratic process, I think we are trying to do the right thing. I have no problem with that. I am not content with the situation one sees presently. But we are talking about a country that has been independent and practicing a democratic way of life only 40 years, including during a civil war.

Mr. OBEY. I understand.

Mr. MONJO. I think to judge them by the standards of a mature democracy may be asking more than one can hope.

Mr. OBEY. Simply since the Administration has been making so many comparisons to the Philippines these days, I am trying to make a comparison of my own.

Mr. MONJO. I have not made a comparison between Korea and the Philippines. They are quite different.

Mr. **Obey**. The Administration has been carefully making a comparison between Nicaragua and the Philippines in order to try to extend that case halfway around the world to a different place.

I would like to have a listing of what we have done, when we have done it, once we have points we have made in terms of trying to impress upon that government the necessity to behave in a way which indicates reasonable sensitivity to our concerns about democratic processes and fairness, if they want us to continue to provide aid to a government that does not reflect American values.

[The information follows:]

We strongly and consistenly encourage political progress and greater respect for human rights in the Republic of Korea. We do so in Washington and Seoul through means both public and private. President Reagan, during his November 1983 visit to Korea, expressed his support for such development on several occasions. For example, before the Korean National Assembly and a live nationwide Korean television audience, President Reagan said, "The development of democratic political institutions is the surest means to build the national consensus that is the foundation of true security. . . . We welcome President Chun's far-sighted plans for a constitutional transfer of power in 1988. Other measures for further development of Korean political life will be equally important and will have our warm support." At a reception in Seoul for distinguished Koreans from many walks of life, including prominent dissidents, President Reagan said,"We also support your development of a democratic political system. . . . The United States pays close attention to political developments in Korea, particularly those affecting democratic rights . . . because such issues are at the center of our own political ideology, and we feel are reflected, then, in our foreign policy." Vice President Bush, during his 1982 visit to Seoul, had an extended discussion with a number of critics of the Korean government. He also addressed the Korean National Assembly, where he expressed support for "noisy" legislatures.

Other senior U.S. Government officials also speak out publicly. Last fall, in the context of a debate in Korea about a Korean government-proposal to set up "rehabilitation centers" for student demonstrators, Paul Wolfowitz, then Assistant Secretary of State for East Asian and Pacific Affairs, delivered an address that scored some recent political steps by the Korean Government as inconsistent with the progress it had made in previous years and commented that political progress in Korea would benefit security on the Korean peninsula and American interests there. Our Ambassador to Korea, Richard L. Walker, in the same context, issued a strong statement on August 13, 1985, in which he said that "the opinions of men are not a legitimate subject for rule by civil government."

While considerations of diplomatic communications preclude providing greater details, all of these U.S. officials and more have expressed similar sentiments in their private contacts with Korean officials. In Seoul, our Ambassador and his staff have been and are currently engaged in a continuing dialogue with the Korean Government and all sectors of society to promote democratic values and progress and greater respect for human rights. These contacts are reinforced in Washington by Department of State contacts with Korean government officials. Such contacts are virtually a daily occurrence and one of the chief elements of our policy toward the Republic of Korea. Our general expressions of support for political progress and greater respect for human rights are accompanied by expressions of interest in such specific issues as the right of citizens to petition their government, charges of police abuse of prisoners, occasional denials of Korean passports to prominent critics of the Korean Government, and restrictions on the exercise of political rights by Korean citizens and politicians.

We believe that our approach is most appropriate to the unique circumstances surrounding the Republic of Korea and that our policy has achieved a number of successes. As President Reagan said during his visit to Korea, we "have faith in the Korean people's ability to find a political system meeting their democratic aspirations, even in the face of the heavy security challenge presented by the North." I can assure you that we will continue our efforts to support and encourage political progress and greater respect in Korea through all appropriate means.

Mr. **Monjo**. May I answer that?

Of course, in this context there will be some restraints based on diplomatic communication.

Mr. **Obey**. Provide what you can for the public record. If you want to provide more by way of a classified report to the Committee, please do that. But I really would like to know what we are doing besides general encouragement to impress on them that we are serious.

Because, very frankly, I think one of the reasons that we were able to avoid more damage to America's image in the Philippines is because of the action of the Congress through the years in squeezing military aid to the Philippines as a signal for them that we were not happy with what they were doing. And given the fact of the tight budget year, I do not see any reason why we could not do the same thing to the Koreans.

Short term that may pinch. Long term if you do not do it, you face what you face in Spain today. We supported that lousy Franco government for umpteen years. And we run the risk of the public wanting to pull the plug on NATO.

Mr. **Monjo**. I only note that neither Spain nor the Philippines, although they have plenty of problems, face an armed North Korea on their border.

Mr. **Obey**. I understand that.

Mr. **Monjo**. Whoever governs in Seoul must face up to it.

Mr. **Obey**. Are you saying that our contribution represented only 5 percent of the military budget?

Mr. **Kelly**. Yes. Our FMS credits represent 5 percent of the ROK defense budget.

Mr. **Obey**. Does anybody really believe that 5 percent is a huge difference——

Mr. **Kelly**. Oh, I do not think so.

Mr. **Obey** [continuing]. In their capacity to fight?

Mr. **Kelly**. I think we must look at the leverage of that 5 percent. Of course, our percentage of assistance in the Philippines, was proportionately much greater. I am not sure I really agree. I think there are disagreements Mr. Chairman, over how much political leverage this assistance provides. There were many people who believed that there should be no military assistance to the Philippines, that we should withdraw all of our people from there, and that we should have no truck at all with the Armed Forces of the Philippines.

Mr. **Obey**. You did not hear me mention withdrawal.

Mr. **Kelly**. No. And I am not suggesting you did.

Mr. **Obey**. I am talking about whether we ought to provide the money you are requesting here. And the other stuff is not on the table.

Mr. **Kelly**. Well, that is the question. But really, sir, when we are involved with at close hand—as an ally—with either an armed forces or government or, as in the case here both. Whether we withdraw from them is really a question of how best we will be able to apply our influence. And we believe we can do it better from the inside or from close by, and that these are reasonable amounts for that purpose.

Mr. **Obey**. I have several other questions I want to submit to you for the record for Korea. [See page 491.]

## VIETNAM

On Vietnam, we have seen instances lately where we have been conducting a search for and actually found the remains of American personnel in Vietnam. Have the Vietnamese asked the United States to participate in or to develop for possible consideration any assistance programs in exchange for allowing an investigation of the POW situation?

Mr. **Kelly**. The answer is no, sir.

Mr. **Obey**. There has been no quid-pro-quo?

Mr. **Monjo**. On the humanitarian issue with which they have agreed, we naturally will fund the expenses involved. That is different. We funded the expenses of the excavation in Laos.

Mr. **Obey**. You had a recent Congressional delegation return suggesting that they felt that there were still some Americans alive in that country. Have those concerns been followed up on in any way? And what is your evaluation of those possible claims?

Mr. **Monjo**. I believe the Administration position is the correct balance, which is not arguing with what those gentlemen said. We follow every possible lead. The Vietnamese government said there is nobody there kept against his will. They recently have changed their position, saying somebody might have stayed on beyond the war, infiltrated, but we do not know of anybody for certain.

It is also true the Vietnamese authorities told us no one was there six years ago when there was. So one must take a certain amount of salt with all of their statements. Each lead is rightly followed up by DIA exhaustively.

Mr. **Obey**. What do we really think? Do we have any information to indicate to us that there might be one, five, ten, you name it, Americans?

Mr. **Monjo**. I cannot give numbers, sir.

Mr. **Kelly**. Well, sir, there is a lot of information that suggests that there may be some Americans or Westerners held against their will somewhere in Indochina. We must consider the live sighting reports, and there have been over 800 over the last ten or twelve years. Of those, more than half, about 60 percent, have been resolved. We were able to identify who was being described.

But we come down to a hard-core number that is of somewhat more than a hundred that are left unsolved. In some cases, individuals giving these reports have had polygraph tests, and we have every reason to believe they were truthful. The evidence has not been firm enough to identify either a particular American or a contemporaneous place and time. If that were to be the case, the President has pledged decisive action.

So we have to proceed on the assumption that there are live Americans there. But the evidence is not able to specifically identify numbers or identify times or places.

Mr. **Obey**. I have four or five other questions I will put in the record at this point. Outside that I do not have any other questions.

[The questions and answers for the record follow:]

## VIETNAM

*Question.* During the past year progress has been made in permitting teams into Vietnam to look for U.S. military personnel that are missing in action. What further investigations will be sought by the United States?

Answer. We seek several forms of investigations:

Investigation of discrepancy cases; that is, where we have clear evidence that an American serviceman was alive just before capture or while in Vietnamese hands, and we have received no information from them on him.

Investigation by the Vietnamese, with American participation where possible, of live sighting reports when in our view doing so is appropriate and will not compromise our sources.

Investigation of loss incidents.

Investigation of aircraft crash sites where we believe an investigation is likely to allow us to resolve a case or cases.

## U.S. ASSISTANCE FOR THAILAND

*Question.* US assistance for Thailand in FY 1987 is proposed to increase from $118 million to $142 million (21% increase). Essentially the entire increase is on the military side. I understand the importance Thailand is serving in terms of the Cambodian situation, but don't you feel that the economic problems in Thailand are as important as increases in military spending?

Answer. Our FY 1987 assistance request for Thailand is in fact only 2% above our FY 1986 request. It represents an attempt to return to a level we feel is essential for Thailand.

As for the security/economic mix of this package, Thailand faces both economic and security challenges. Its economy has slowed, its debt levels increased and the budget is temporarily constrained. It confronts a huge task in providing employment and a decent livelihood for a large population. Our modest bilateral economic assistance program is valuable in targeting specific high priority areas. That assistance in FY 1987 will be used to help Thailand address key policy constraints, rural unemployment problems, and broaden its technological base.

At the same time, Thailand confronts a very real security threat from the Soviet-supported Vietnamese occupation of Cambodia. Should Thailand be the victim of communist aggression, under the terms of the Manila Pact we have the obligation to act to meet that common danger in accordance with our constitutional processes. In order to maintain a military capability sufficient to deter Vietnamese aggression, the Thailand forces must modernize. Thailand finances much of this program itself yet requires outside assistance as well. The United States is in the best position to provide this through an adequate security assistance program.

Given the totality of Thailand's developmental and security requiements and the various sources available for both types of aid, we believe the current mix in our bilateral assistance program emphasizing security assistance, is appropriate.

## KOREA

*Question.* Although the economy of Korea appears to continue to expand, and the U.S. is feeling the result of stiff competition with the Koreans on many fronts, the U.S. FMS program for Korea proposed for FY 1987 is one of the largest increases in this year's Foreign Assistance program.

The Administration's request proposes to increase FMS from $163 million in FY 1986 to $230 in FY 1987.

Based on our own budgetary circumstances, how do we justify such a large increase in FMS for Korea?

Answer. The request for $230 million for FY 1987 simply returns FMS funding to Korea to the level funded in FY 1984 and 1985.

*Question.* If you are telling me that you are simply returning to the levels provided in FY 1985, then you are not being aware of the budget restraints that have taken place since then. Why won't Korea be used as an example for restraining Foreign Assistance spending?

Answer. We learned the hard way in 1950 that US interests are not served by inviting North Korean miscalculations about the constancy of the US as an ally.

Over the past two years, the North Korean military threat has grown more formidable. As you know, renewed hostilities on the Korean peninsula would directly affect US security interests. Despite economic difficulties, South Korea makes major efforts itself to counter the North Korean threat. The ROK now spends about six percent of its GNP on defense—a higher percentage than most of our other allies—and is engaged in a major force improvement program.

We should not forget that the FMS program in Korea has benefitted US industry. In the past the ROK has spent some 3 to 4 times the amount of its FMS credit level for military purchases in the US.

*Question.* During the past year there has been a great deal of political turmoil in Korea, including the emergence of a new opposition party (the New Korea Democratic Party). The South Korean government has adopted a progressively tougher stand toward its opponents, including arrests of student activists, the imposition of periodic house arrest on opposition politicans, and police measures to prevent the New Korea Democratic Party and its allies from launching a petition campaign to collect ten million signatures in support of amending the constitution (in order to provide a direct presidential election in 1988).

Are there any ties between our FMS program in Korea, and the Government's ability to produce a good record on the human rights issue?

Answer. US security assistance to Korea provides a shield behind which Koreans can have the confidence necessary to continue to achieve economic and political progress. The importance of our security assistance to Korea allows us considerable access to the Government of the Republic of Korea, which we can and do use to encourage political development and respect for human rights. I believe Korean understanding of this role is reflected in the fact that no significant opposition figure in Korea calls for the withdrawal of American troops or a reduction in our FMS credits to Korea.

*Question.* What is the Administration doing to work toward free and fair Presidential election in Korea in 1988? Do you believe that a fair election can be held within the framework of the present electoral college system?

Answer. The Administration has consistently promoted political progress and respect for human rights in Korea, both publicly and privately, with the Korean Government and with opposition parties and dissident groups. We have expressed our hope for a free and fair presidential election as we did for the 1985 National Assembly election. Whether the present electoral college system is fair is the subject of the central partisan political debate underway in Korea, and it would be inappropriate for the U.S. to preempt what should be a Korean decision. We have, however, clearly and consistently expressed our view that the right of citizens to petition their government is a basic democratic principle.

## U.S. ASSISTANCE TO BURMA

*Question.* Secretary Monjo, in your opening statement you point out that Burma "ranks among the world's poorest countries. It has a per capita income of less than $190." If that is the case, why are we initiating a brand new military assistance program in Burma while providing no economic support funds and no increase in Development Assistance?

Answer. We are requesting $1 million in *grant* Military Assistance Program (MAP) funds to assist the Burmese Government to replace worn-out and obsolete military equipment and weapons used by the Burnese armed forces. The Burmese military is engaged in a protracted struggle against Burmese insurgent and warlord groups, the majority of which are directly involved in narcotics production and/or traffficking. These groups use profits from narcotics to obtain weaponry and equipment that generally is superior to that now available to the government forces.

ESF is normally provided to promote economic or political stability or to avert major crises where the U.S. has special foreign policy interests. While the U.S. is interested in the stability and progress of Burma, we believe Development Assistance (DA) is more appropriate than ESF to support Burma's longterm potential for economic growth. Our request for $10 million in DA, which is equal to the FY-86 funding level, is sufficient to support existing and planned AID-assisted development projects in Burma. Specifically, this funding level will permit AID to continue technological and institutional improvements in agriculture, provide new helth technologies, and assist in developing Burma's human resources.

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*Question.* The anti-narcotics program for Burma already has a 59 percent increase in funding, increasing from $5.5 million to $8.8 million. Why do you need both a large anti-narcotics program and a new military program?

Answer. International Narcotics Control (INC) funds provided under Section 481 of the Foreign Assistance Act (FAA) permit us to assist the Burmese Government on crop control and narcotics enforcement projects. However, Section 482(b)(2) of the FAA prohibits use of those funds for procurement of arms or ammunition.

*Question.* Based on the economic situation in Burma (less than $50 million in foreign currency reserves, debt of 43%), do you believe we should saddle that country with additional military purchases?

Answer. Burma is indeed facing serious economic problems. At the same time, the Burmese Government views the insurgencies and illicit narcotics as interrelated matters affecting the nation's security, and thus is determined to continue its fight to end both problems despite the drain on scarce government resources. We do not want to saddle the Government with additional military purchases and therefore are requesting grant military assistance.

### MALAYSIA—FMS CREDITS

*Question.* Secretary Monjo, in your statement you indicate that in the past Malaysia has not made use of the FMS credits we have provided to them.

Why have you, then, increased the FMS program from $1.9 to $5.0 million (161%)?

Is this an example of areas that have been overlooked for "trimming" in FY 1986?

Answer. The apparent increase in FMS program credits for Malaysia in FY-1987 is just that, apparent. In early planning for FY-1986, we had hoped to maintain the program for Malaysia at $5.0 million. As the full impact of budget cutting became evident, we in fact "trimmed" the Malaysia request to $2.0 million. The figure of $1.9 million presented to Congress takes into account "sequestering" required under Gramm-Rudman-Hollings. The $2.0 million figure represented a compromise between $5.0 million, which would have been consistent with earleir levels, and no program for Malaysia, which would have sent the wrong kind of signal.

In the past several years, the Government of Malaysia has called for a restructuring of the Malaysian armed forces away from counter-insurgency toward a more conventional force posture. This change created new equipment needs. Simultaneously, Malaysia's economy, which is based on exports of commodities (oil, rubber, tin, palm oil) and manufactured goods (especially semiconductors) has been hard hit by a worldwide decline in demand and price for all of these goods. With reduced earnings from exports, the Malaysian government has introduced a series of austerity budgets. The military has not been exempted from cuts and indeed has received little in the way of new funds for weapons purchases.

At the same time, the Government of Malaysia's fiscal prudence has led it to resist assuming new credits. Its debt service ratio reached 16 percent in 1985 and may go higher this year. Thus, Malaysia has been slow to utilize FMS credits over the past several years because of budgetary constraints and fiscal responsibility in taking on new debt. Nevertheless, the Malaysians have assured us they value our offers of FMS support and have stated their intention to take advantage of these credits as their economic situation improves.

Since the visit of Malaysian Prime Minister Mahathir Mohamad to Washington in January 1984, there has been a perceptible warming in our bilateral relationship. Malaysia's membership in the Non-aligned Movement and Organization of Islamic Conference, of course, put limits on how close our relationship can become. There has, however, been a steady increase in government-to-government contacts at all levels, and we believe our making FMS credits available has enhanced this process. It is for these reasons we hope our budget situation may permit restoration of the program for Malaysia to $5.0 million in FY-1987.

*Question.* Given the recent complications involving U.S. interests in the South Pacific, is the Administration's FY-87 aid request sufficient to protect and promote U.S. interests in the region? For instance, given Soviet activities in the region and the impasse in U.S.-New Zealand relations over New Zealand's refusal to allow U.S. nuclear-powered or nuclear-armed warships to visit the county, should the United States be doing more on its own to cultivate good ties with the states of Oceania and safeguard its strategic access to the region?

Answer. The FY-87 request evolved in the present budget environment. It is a bare bones, holding action approach intended to preserve, not expand, U.S. influence in the region. It does not represent, and we should not think it does, a resource level sufficient to prevent Soviet influence from spreading.

However, it should be remembered that we are dealing with an area that is fundamentally pro-western and pro-U.S. As a consequence, we need not match the Soviets dollar for dollar in order to effectively frustrate their ambitions in the region and further our own. While our regional assistance program has been a valuable policy tool for the U.S., its limited resources have placed clear constraints on what it reasonably can be expected to accomplish. However, a relatively modest increase in the program's budget could make it an exceptionally effective vehicle for promoting U.S. interests and countering Soviet activities in the region.

*Question.* If a more active aid effort appears warranted should U.S aid be channeled directly to individual countries, thereby increasing the positive political impact of the aid on particular South Pacific countries? Or should the United States continue to funnel half of its aid through regional organizations and programs, that some see as obscuring the U.S. contribution to the welfare of the countries of the region?

Answer. In recent years virtually all of the ten AID-recipient South Pacific nations have, formally or informally, requested bilateral assistance from the U.S. However, with the exception of a modest bilaterial assistance program for Fiji scheduled to begin in FY-86, AID has maintained the development assistance modes it articulated to Congress in 1977 when we began the South Pacific program. Given current estimates of funding and years, providing assistance through intermediaries and/or in a regional program context offers the most realistic approach to development assistance for the South Pacific. At the same time, we are pursuing ways to make AID support to these programs more visible to beneficiaries and host governments. This includes encouraging greater and more equitable participation in our regional program, which will be strengthened by new training, private enterprise and fisheries projects this years.

Mr. McHugh. Just one or two more questions on the missing-in-action issue. It is my understanding that the Administration assumes there are people still alive in Southeast Asia for the purpose of not closing the case. That is to say, these live sighting cases, even if we cannot establish that there is someone there, are not closed cases?

Mr. Kelly. They certainly are not.

Mr. McHugh. And there is an assumption for purposes of the investigation that there are people out there.

Mr. Kelly. Yes, sir.

Mr. McHugh. Even though we do not have solid evidence that this is the case.

Mr. Kelly. So we energetically pursue every investigation lead that may come up on that.

### MARCOS

Mr. McHugh. There is one more thread I want to pursue on Mr. Marcos. I would like to make it clear that my own view is that Mr. Marcos should compensate the taxpayers of the United States for these costs that you described. I say that recognizing that the people in our Government who deal with Mr. Marcos probably will not be inclined to tender a bill for any number of reasons.

But speaking for myself and I think many others, certainly many of my constituents, I am concerned less about Mr. Marcos' bills, than I am about the flexibility that a future President might need in allowing someone like a Mr. Marcos to come to this country to avoid the problems that would otherwise occur.

Pursuing the same point I made earlier, if the people of the United States believe that Mr. Marcos has $3 billion in Swiss bank accounts or even a fraction of that, yet they are picking up the bill for his travel expenses and his telephone calls, they might not support the decision of a future President to allow such foreign leaders sanctuary for purposes consistent with our national interest.

That is my problem beyond the justice of Mr. Marcos paying his bills. I would like to underline that concern and hope that the Administration will require Mr. Marcos to pick up his costs rather than the taxpayers of this country.

### MALAYSIA'S POLITICAL STABILITY

Mr. OBEY. Let me ask one other question which I forgot earlier. Your testimony mentioned that Malaysia's continued political stability is essential to U.S. interests in the region. There have been some reports recently of the rise of Islamic fundamentalism in Malaysia and elsewhere in that region. What is your evaluation of that situation?

Mr. MONJO. I think what you see in Malaysia and Indonesia and some of the other countries is basically a fluctuating situation Malaysia may be 66 percent and Indonesia 90 percent Moslem. You see influences, certainly from some of the more radical countries while up until recently, with oil prices high they have also been well off countries.

I think you see these governments trying to Islamicize themselves, or at least permit their people to do that to the extent that they can without becoming radical. In other words, to have a situation that evolves in a reasonably healthy way rather than stonewall.

In Malaysia you will find that when there are real radicals like those in one small village where they went in and stopped the village the Government went and took action against what was becoming truly a center for rebellious elements. So I think you see governments trying to measure and satisfy true religious asperations, if you will.

Mr. OBEY. Thank you very much, gentleman.

## Question for the Record

### ISLAMIC FUNDAMENTALISM IN SOUTHEAST ASIA

*Question.* There have been reports recently of the rise of Islamic fundamentalism in Malaysia and elsewhere in Southeast Asia. In his testimony on March 12, Assistant Secretary Monjo indicated that governments in the region are not seriously threatened by these religious movements.

How have these movements developed and how does the situation in each affected country today compare with that of a few years ago?

Is the stability of Malaysia threatened? That of Indonesia? Please provide a detailed response for the record for each country in the region which is having, or may have to contend with Islamic movements.

Answer. Approximately 160 million Muslims live in the peninsula and archipelagic arc of Southeast Asia, stretching from the southern provinces of Thailand, through West Malaysia, into Indonesia, East Malaysia and Brunei, and up to the southern islands of the Philippines. Besides Brunei, Muslims are a majority in Indonesia, where 90 percent of the population of 161 million profess Islam. In racially plural Malaysia, Muslims, including South Asian immigrants and Chinese converts, are about 53 percent of the population.

Since Islam reached Southeast Asia in the thirteenth century with the appearance of Muslim traders in coastal towns, Islamic practice has been influenced by trends in Islamic thought originating outside the region. That process continues today. Muslims in Southeast Asia know what is going on elsewhere in the Islamic world, and those debates resound there. The dynamics of Islamic politics and "fundamentalism" in the domestic settings of the six states which comprise ASEAN, the

Association of Southeast Asian Nations, however, can only partially be explained by externalities of the so-called "Islamic revolution."

Most Muslims in Southeast Asia today live in lands not under Muslim authority, even through indigenous nationalist authority has supplanted western colonialist rulers. Rather than being able to perfect a moral and just society based on Islamic social, economic and political institutions, many Muslims in Southeast Asia feel Islam, and hence their own relation with God, is threatened in the framework of the modern nation state. Added to this, in the Philippines and Thailand, the Muslim "problem" is one of minority autonomy or separatism.

*Malaysia:* Recently resigned Malaysian Deputy Prime Minister Musa Hitam has described the abuse of religion for political purposes as the third major challenge to Malaysia's stability. The first two were the Communist insurgency (1948–60) and communalism, which culminated in the riots of May 1969. At the same time Malaysia's democratically elected government feels it must be responsive to the growth in genuine Islamic piety, especially since it believes modernization and development are compatible with an Islamic resurgence which does not threaten the interests of other ethnic groups. Therefore, it has followed policies at home and internationally which reflect Islam's place as Malaysia's official religion and Malaysian membership in the Organization of Islamic Conference. While reconciliation of these conflicting strains requires deft and delicate handling, we believe Malaysia will remain stable and a moderate, responsible international voice.

*Indonesia:* At independence, an attempt was made by Muslim politicians to establish an Islamic State. That effort lost soundly to secular nationalist politicians largely because most Indonesian freedom fighters considered themselves nationalists and did not identity their religious beliefs with the struggle. Since then, the debate has been essentially closed.

In Indonesia today, there is growing interest in Islamic teachings and increased attention to religious ritual and correct practice. This reflects awareness of recent trends in the Middle East, Iran and other Islamic countries, as well as doubts about the impact of rapid modernization on traditional values.

The Government of Indonesia regards religious "extremism" as a threat to national security second only to revival of the Indonesian Communist Party. A series of incidents—including a riot, arson and bombings—in the second half of 1984 and much of 1985 reinforced government concern about Islamic extremism.

While these events have caused concern, they do not, in our view, reflect disenchantment by the vast majority of Indonesians with the approach to religion followed by the government since independence. Moreover, in the multi-faceted religious milieu of Indonesia, tolerance, embodied in the national ideology, Pancasila, is at odds with religious extremism.

*Brunei:* Brunei is the most thoroughly Islamized state in Southeast Asia. The historic character of the Sultanate remains as it has been since the 15th century, i.e., a Malay Muslim monarchy based on the teachings of Islam. The royal family, proud of the continuity of the regime, views the monarchy as the repository of legitimate Islamic Malay religion, custom, tradition and law that has made possible the preservation of a genuine Malay culture and political identity. Islam buttresses the political order in Brunei, and Brunei is a Islamic state, a fact translated rigorously into the daily life of Brunei's Malay citizens.

Given the Islamic nature of the regime, Brunei has been less influenced than either Malaysia or Indonesia by the foment in islam over the past 20 years. For the time being, neither fundamentalism nor extremisn have found a place in Brunei. While it is conceivable that opponents of the monarchy could at some point offer an alternative Islamic model of society based of fundamentalist precepts, there are no immediate signs of such tendencies.

*Singapore:* Muslims comprise just under 20 percent of Singapore's population. Malay Muslims make up 15.5 percent. The original inhabitants of Singapore, today they exist in a political economy structured by a non-Muslim, immigrant Chinese majority. In a real sense the Malay Muslims of Singapore represent not just an ethno-religious minority, but also an underclass lagging far behing is social and economic achievements. The problem for Muslims in Singapore is whether their Malay identity perpetuates them as an underclass.

The Government of Singapore is aware of the difficulties inherent in allowing ethnically based socio-economic distinctions to perisist. While there are no indications of attemps to exploit the economic backwardness of the Malays by fundamentalist Islamic elements at this point, this is an area for potential concern in the future.

*Thailand and the Philippines:* Muslims are small but territorially concentrated minorities in Buddhist Thailand and Christian Philippines. In both countries, Muslim separatism is an ongoing problem. Allegations have been made that Muslim separatists receive arms and financial assistance from outside the region. While evidence for direct assistance is slim in the case of Thailand, Libyan support for the Moro National Liberation Front in the southern Philippines is an open secret.

In the Philippines, separatism has not manifested itself as a religious movement. Philippine Muslims are deeply divided along ethnic/traditional lines, and there is no broad agreement on the place of religion should the separatists succeed in winning either substantial autonomy or (highly unlikely) independence. Thus, while there are fundamentalist elements and influences among the various Muslim separatist groups, religious issues are far less important than day-to-day questions of sustaining the spearatist movement and containing its fissiparous tendencies.

In Thailand, most Muslims live in the southern region with about one million of them in the four provinces closest to Malaysia. They are ethnically and culturally Malay. The forcement pressing of assimilationist policies by Thai nationalist elites beginning in the 1930's and 1940's fostered a Thai Muslim Political identity at the same time the Malay Muslim nationalism was wresting control of an independent Malayan state from the British. This Thai Muslim political identity later manifested itself in an on-again, off-again separatist movement in the south.

For now, Muslim separatism in Thailand has been contained by more elightened government policies of the last five years. There is, however, among Thai Muslims a desire to preserve their cultural identity. These feelings are reinforced by the widely known developments in Islam in Malaysia and concern about the possibility of renewed efforts to compel adoption of total Thai identity. Under these circumstances, Thai officials are understandably concerned about the possible spread of Islamic "extremism." Nevertheless, we are not aware of evidence to suggest a coalescence between separatist and fundamentalist forces, and we do not anticipate such linkages as long as Thai government policies continue to exhibit sensitivity to the cultural differences of ethnic Malay Thai Muslims.

WEDNESDAY, MARCH 12, 1986.

# SOUTH ASIA REGIONAL HEARING

## WITNESSES

ARNOLD L. RAPHEL, PRINCIPAL DEPUTY ASSISTANT SECRETARY, NEAR EASTERN AFFAIRS, U.S. DEPARTMENT OF STATE

CHARLES W. GREENLEAF, JR., ASSISTANT ADMINISTRATOR, BUREAU FOR ASIA AND NEAR EAST, AGENCY FOR INTERNATIONAL DEVELOPMENT

LIEUTENANT GENERAL PHILIP GAST, DIRECTOR, DEFENSE SECURITY ASSISTANCE AGENCY

### FY '87 REQUEST FOR SOUTH ASIA

Mr. OBEY. This afternoon the Committee will hear the Administration witnesses on the fiscal 1987 request for U.S. assistance in South Asia. The fiscal '87 request of $876 million, is a $40 million increase, about 5 percent above the FY-86 with the sequestration level under which we are now operating.

Essentially the entire increase is for security systems in Pakistan. The Soviet occupation of Afghanistan obviously continues to dominate the issues in South Asia. And consequently Pakistan is the largest recipient.

In addition to examining the AID program in Pakistan, we will be raising questions on the $15 million program for the assistance to Afghan rebels. And we will also be interested in whatever you gentlemen have to say on our programs in India, Sri Lanka, and other countries in the region.

We have with us today Mr. Arnold Raphel, Principal Deputy Assistant Secretary, Near Eastern Affairs; Mr. Charles Greenleaf, Assistant Administrator, Bureau for Asia and Near East, Agency for International Development; Lieutenant General Philip Gast, Director of Defense Security Assistance Agency.

Gentlemen, it is your pleasure.

Mr. RAPHEL. Thank you, Mr. Chairman I appreciate the opportunity to come before the Subcommittee today on assistance in South Asia. If you agree, sir, I would like to summarize briefly the prepared statement we submitted earlier and answer any questions you may have.

Mr. OBEY. Sure.

Mr. RAPHEL. Our interests in South Asia reflect the importance of the region, both because of its size, military, economic, technological, and diplomatic strength, and because of its location.

We have seven key objectives in South Asia. First is to deter Soviet expansionism. Second, to support economic growth and development. Third, to prevent nuclear proliferation. Fourth, to support the development and strengthening of democratic institutions.

Fifth, to reduce production, transit, and export of narcotics. Sixth, to encourage independence, not interference, while promoting regional cooperation. And finally, to expand mutually beneficial economic and commercial ties.

To succeed we must seek a relationship of trust and confidence in all nations. Our interests are best served by a stable and independent South Asia, nations which grow stronger in a peaceful environment and are capable of deterring interference from outside the region.

In our role of supporting South Asia, we seek no military bases in the region. We do not want to expand relations with one of the nations at the expense of others. And we have no desire to upset the security balances among states in the region.

Let me briefly highlight the situation in several key countries.

In Pakistan, our goal is a secure, independent and productive Pakistan which serves our own interests and the interests of all South Asia. Pakistan is a front line state. Pakistan is giving haven to between 2 and a half and 3 million Afghan refugees.

In 1981 the Administration with the full support of Congress, committed itself to seek a $3.2 million, six-year economic and five-year military assistance program split evenly between economic and military assistance. That program, which enters its final year in FY-87, has been noteably successful in meeting multi-year objectives, with Congress' supported assistance program at near full funding, except for cuts mandated by Gramm-Rudman-Hollings in FY-86.

We hope to continue this in FY-87 and we are now discussing a follow-on, multi-year program for the Pakistan government. If you wish later, Mr. Chairman, I can give you the details of that.

The pressures facing Pakistan in 1981, which warranted that major U.S. assistance program, have not abated. In fact, during 1985 these pressures increased. Soviet efforts at intimidation were stepped up. Cross border subversions, attacks from inside Afghanistan to Pakistan, leaving over 250 civilians inside Pakistan dead or wounded and undermining Pakistan's security, continued throughout the year.

Confident of our support, Pakistan has remained steadfast despite these threats. Pakistan refuses to recognize the Soviet controlled regime in Kabul or to acquiesce in the continuing Soviet efforts to subjugate the Afghan people.

We are hopeful and heartened by Pakistan's return to an elected constitutional government. We believe that the continuing assurance of our economic and security assistance helps create the domestic conditions in Pakistan necessary for continued political evolution and stability.

This is one reason we believe a multi-year, follow-on program is crucial. It helps ensure that despite Soviet subversion and cross border threats, democracy will grow in Pakistan and durable political institutions will develop.

Another critical U.S. interest served by our assistance program is non-proliferation. While President Zia and Prime Minister Junejo have publicly made assurances regarding the peaceful nature of the Pakistani nuclear program, we have continued to convey to the Pakistan government on numerous occasions and at the highest levels our concerns about unsafeguarded nuclear facilities in that country. We are confident that our message that Pakistani nuclear restraint is essential to our ability to provide security assistance has been clearly understood.

India, the predominant regional power in South Asia, plays a pivotal role in regional peace and stability. Our AID program in India is now small in comparison to India's total needs. The US AID program mirrors our broader Indo-U.S. relationship where high technology has become a key element of scientific collaboration.

A science and technology initiative begun in 1980 and extended during Prime Minister Rajiv Gandhi's visit to Washington last year is supported in part by AID. Its purpose is to concentrate on a few areas of research of great potential benefit to those countries.

Indo-U.S. trade in high technology items has been stimulated by negotiation of a memorandum of understanding to protect our technology. This should help preserve our position as India's leading partner in both trade and business collaboration.

In Bangladesh, our assistance serves two purposes. First, to ensure that this nation of 100 million has its basic human needs met, especially the provision of adequate food supply; and second, to establish conditions for sustainable economic growth.

We concurrently seek to encourage long-term political stability under representative institutions.

The United States plays a useful role in helping Bangladesh pursue its twin goals of economic and political development. We know that in the long run one is not possible without the other. And our assistance program is our chief tool in the process.

Sri Lanka. We have had a long and close relationship with that democratic nation. We have watched with concern, however, as severe communal problems have increasingly threatened the social and political fabric of Sri Lanka.

Militant elements in the minority community have in the past year broadened their attacks on security forces to include Sinhalese and Tamil civilians. The response of the security forces, while fully justified in principle, has frequently entailed excessive loss of life among Tamil civilians.

A negotiated solution to the insurgency is essential if peace is to be restored in the country. We do not believe a purely military solution is possible. We support the unity and integrity of Sri Lanka, and oppose the establishment of a separate state.

Finally, Nepal. The location between India and China makes the maintenance of its domestic stability important in the regional context. Our economic assistance to Nepal is entirely on a grant basis and essentially humanitarian in nature. It contributes to that nation's continued stability and economic development through programs designed to improve the quality of life of the Nepalese people.

Thank you, Mr. Chairman. If you have any questions of Mr. Greenleaf or General Gast.

[Statement follows:]

ARNOLD L. RAPHEL
STATEMENT OF ~~ROBERT A. PECK~~
PRINCIPAL DEPUTY ASSISTANT SECRETARY
BUREAU OF NEAR EASTERN AND SOUTH ASIAN AFFAIRS
DEPARTMENT OF STATE

BEFORE THE

SUBCOMMITTEE ON FOREIGN OPERATIONS
HOUSE APPROPRIATIONS COMMITTEE

MARCH 12, 1986

Mr. Chairman and Members of Subcommittee:

I appreciate this opportunity to testify before the Subcommittee on the Administration's proposed foreign assistance program for South Asia in FY 1987. I will do my best to address your concerns and to answer any questions you may have.

I propose to begin my statement by presenting the levels that we are requesting, then to explain how the amounts, mix, and design of our proposed programs serve U.S. interests and objectives in South Asia.

Program Levels

The following table details the Administration's FY 1987 appropriations request for South Asia. The levels of the previous two years are included for purposes of comparision:

## U.S. ASSISTANCE LEVELS
($ MILLIONS)

| | (Actual) FY 1985 | (Est.) FY 1986 | (Req.) FY 1987 |
|---|---|---|---|
| **Afghan Humanitarian** | | | |
| ESF | --- | 14.355 | 15.0 |
| **Bangladesh** | | | |
| Development Assistance | 85.070 | 75.0 | 75.0 |
| PL-480, Title I/III | 94.5 | 70.0 | 64.0 |
| PL-480, Title II* | 18.968 | 16.799 | 16.323 |
| IMET | 0.336 | 0.263 | 0.370 |
| Total | 198.874 | 162.062 | 155.693 |
| **India** | | | |
| Development Assistance | 85.0 | 75.0 | 72.0 |
| PL-480, Title II* | 90.767 | 80.377 | 80.459 |
| IMET | 0.282 | 0.311 | 0.400 |
| Total | 176.049 | 155.688 | 152.859 |
| **Nepal** | | | |
| Development Assistance | 19.128 | 14.400 | 14.400 |
| IMET | 0.125 | 0.096 | 0.125 |
| Total | 19.253 | 14.496 | 14.525 |
| **Pakistan** | | | |
| ESF | 200.0 | 239.25 | 250.0 |
| Development Assistance | 50.0 | 24.0 | 25.0 |
| PL-480 Title I | 59.0 | 50.0 | 50.0 |
| FMS | 325.0 | 311.025 | 340.0 |
| IMET | 0.970 | 0.885 | 1.4 |
| Total | 634.970 | 625.160 | 666.4 |
| **Sri Lanka** | | | |
| Development Assistance | 34.662 | 20.0 | 20.0 |
| PL-480, Title I | 26.0 | 26.0 | 19.0 |
| PL-480, Title II* | 3.855 | 2.746 | 2.029 |
| IMET | 0.148 | 0.144 | 0.185 |
| Total | 64.665 | 48.890 | 41.214 |
| **Maldives** | | | |
| PL-480, Title I | 1.5 | --- | --- |
| IMET | 0.022 | 0.024 | 0.055 |
| Total | 1.522 | 0.024 | 0.055 |
| GRAND TOTAL | 1086.333 | 1020.675 | 1045.746 |

*These figures do not include PL-480, Title II food assistance provided through the World Food Program for Bangladesh, Bhutan, India, Nepal, Pakistan, and Sri Lanka, nor $7 million in ESF mixed credits to be extended to India in FY 86.

Let me attempt to put these figures in perspective. The request of $1.045 billion for the nations of South Asia represents about 6.4 percent of the Administration's total worldwide FY 1987 budget request, down slightly from the South Asia region's 6.7 percent share in FY 1986 post-sequester totals.

Taking account of all countries except Pakistan, which I will discuss separately below, we are proposing a total budget allocation of $379.3 million, or a 4.1 percent decrease from the FY 1986 levels. This decrease reflects worldwide cuts in our economic assistance; the bulk of this moderate decrease is in PL-480 food and commodity aid and/or development assistance for Bangladesh, Sri Lanka and India. Of the projected South Asia total, again excluding Pakistan, $181.4 million is earmarked for development assistance, $181.8 million for PL-480 food and commodity aid, and $1.14 million for International Military Education and Training (IMET). An additional $15 million of Economic Support Fund assistance is earmarked for humanitarian assistance to war-impacted Afghans.

The Pakistan program involves certain special considerations which I will cover in some detail later in this testimony. For

Pakistan. We are requesting $340 million in FMS credits and $325 million in a mix of economic assistance programs. These totals, which reflect a 6.5 percent increase over the FY 1986 estimates, are in accordance with the multi-year Pakistan assistance program agreed to with the Pakistan Government in 1981 and involving, as you will recall, close consultation with Congress. We are also requesting $1.4 million in IMET assistance, compared to $885 thousand in FY 1986.

It is relevant to ask what impact our proposed economic assistance will have on the debt service burden of the recipient nations. This burden remains at manageable levels throughout South Asia, although the trend is rising in the case of several countries, notably Bangladesh, where the debt service ratio is estimated at 21.5 percent. Debt service, as a percent of goods and services plus remittances from expatriate workers, is under 20 percent in all of the other countries. Recognizing this concern, our economic aid throughout South Asia contains a large grant element; in the two poorest countries of the region, Bangladesh and Nepal, our assistance is entirely on a grant basis. Thus, in those two countries, and more generally, our aid provides an important boost to the development process without adding dangerously to future repayment difficulties.

## U.S. INTERESTS AND OBJECTIVES IN SOUTH ASIA

OUR INTERESTS IN SOUTH ASIA REFLECT THE IMPORTANCE OF THE REGION BOTH BECAUSE OF ITS SIZE, MILITARY, ECONOMIC, TECHNOLOGICAL AND DIPLOMATIC STRENGTH, AND BECAUSE OF ITS LOCATION.

TOGETHER, ITS COUNTRIES ACCOUNT FOR ABOUT ONE BILLION PEOPLE, OR MORE THAN 20 PERCENT OF THE GLOBAL TOTAL. MILITARY FORCES THERE INCLUDE INDIA'S AS THE 4TH AND PAKISTAN'S AS THE 12TH LARGEST IN THE WORLD. SOUTH ASIA HAS THE LARGEST POOL OF SCIENTIFIC AND TECHNOLOGICAL MANPOWER OUTSIDE NORTH AMERICA, WESTERN EUROPE, AND THE SOVIET UNION AND HAS BEEN A SOURCE OF SUCH MANPOWER FOR OTHER NATIONS OF NEIGHBORING COUNTRIES, NOTABLY THE GULF. ITS NATIONS ARE CONSISTENT LEADERS IN MULTILATERAL ORGANIZATIONS, AND IT HAS BEEN LONG A SEEDBED AND A SUCCESS STORY FOR THE MODERN TOOLS AND TECHNIQUES OF ECONOMIC AND SOCIAL DEVELOPMENT. SOUTH ASIA HAS SOME OF THE WORLD'S POOREST NATIONS AS WELL AS SOME OF THE MOST REMARKABLY DEVELOPING.

THE AREA, MOREOVER, IS STRATEGICALLY LOCATED CLOSE TO THE ENERGY RESOURCES OF SOUTHWEST ASIA AND THE GULF AND IMMEDIATELY

SOUTH OF BOTH CHINA AND THE SOVIET UNION. IT IS THE DOMINANT GEOGRAPHIC FEATURE IN THE INDIAN OCEAN REGION AND, IN INDIA, HAS THE LARGEST NAVAL FORCE IN THE INDIAN OCEAN/ARABIAN SEA AREA.

OUR OBJECTIVES IN THIS REGION INCLUDE:

-- DETERRING SOVIET EXPANSIONISM;

-- SUPPORTING ECONOMIC GROWTH AND DEVELOPMENT;

-- PREVENTING NUCLEAR PROLIFERATION;

-- SUPPORTING THE DEVELOPMENT AND STRENGTHENING OF DEMOCRATIC INSTITUTIONS;

-- REDUCING PRODUCTION, TRANSIT, AND EXPORT OF NARCOTICS;

-- ENCOURAGING INDEPENDENCE AND NON-INTERFERENCE WHILE PROMOTING PEACEFUL RESOLUTION OF REGIONAL DIFFERENCES AND EXPANSION OF REGIONAL COOPERATION;

-- EXPANDING MUTUALLY BENEFICIAL ECONOMIC AND COMMERCIAL TIES.

PURSUIT OF THESE GOALS REQUIRES THAT WE SEEK RELATIONS OF TRUST AND CONFIDENCE WITH ALL NATIONS OF THE REGION. OUR INTERESTS ARE BEST SERVED BY STABLE AND INDEPENDENT SOUTH ASIAN NATIONS, GROWING STRONGER IN A PEACEFUL ENVIRONMENT AND CAPABLE OF DETERRING INTERFERENCE FROM OUTSIDE THE REGION. OUR ROLE IS TO SUPPORT SOUTH ASIA'S OWN SECURITY AND DEVELOPMENTAL EFFORTS. WE SEEK NO RPT NO MILITARY BASES IN THE REGION. WE DO NOT WANT TO EXPAND RELATIONS WITH ONE OF THE NATIONS IN THE REGION AT THE EXPENSE OF OTHERS. WE HAVE NO DESIRE TO UPSET THE SECURITY BALANCES NOW EXISTING AMONG STATES IN THE REGION.

## HOW OUR PROGRAMS SERVE U.S. INTERESTS AND OBJECTIVES

OUR SOUTH ASIA ASSISTANCE PROGRAMS REFLECT THE DIFFERING ECONOMIC AND STRATEGIC CONDITIONS IN THE REGION. PROGRAMS ARE DESIGNED TO MEET THE UNIQUE CIRCUMSTANCE AND OPPORTUNITY IN EACH COUNTRY WITHIN EVER TIGHTENING BUDGET CONSTRAINTS. WHILE EMPHASES VARY, EACH, WE BELIEVE, FULFILLS KEY US OBJECTIVES IN THE REGION AND ON A BILATERAL BASIS. SECURITY FORMS THE MAIN THRUST OF THE PAKISTAN PROGRAM, FOR EXAMPLE, IN LIGHT OF THE SOVIET THREAT IN NEIGHBORING AFGHANISTAN.

THE PROGRAM IN INDIA HAS EVOLVED OVER THE YEARS INTO A JOINT

EFFORT WHICH BUILDS ON AN IMPRESSIVE INSTITUTIONAL AND TECHNOLOGICAL INFRASTRUCTURE. IN EVERY SOUTH ASIAN COUNTRY WITH A U.S. PROGRAM, DEVELOPMENT ASSISTANCE FORMS A SIZEABLE IF NOT DECISIVE PORTION OF OUR AID. PARTICULARLY IN BANGLADESH, SRI LANKA, AND NEPAL, U.S. ASSISTANCE IS AIMED AT INSURING AN ADEQUATE FOOD SUPPLY AND FURTHERING BASIC HUMANITARIAN AND DEVELOPMENTAL OBJECTIVES. IN ALL OF THE LARGER COUNTRIES, INTERNATIONAL MILITARY EDUCATION AND TRAINING (IMET) PROGRAMS HELP TO CONSTRUCT DURABLE TIES BETWEEN THE U.S. ARMED SERVICES AND THEIR SOUTH ASIAN COUNTERPARTS WHILE OUR IMET PROGRAM IN THE MALDIVES PROVIDES A TANGIBLE AND MUTUALLY BENEFICIAL LINKAGE BETWEEN OUR TWO NATIONS. IT HAS BEEN OUR EXPERIENCE OVER MORE THAN THIRTY YEARS OF INVOLVEMENT IN SOUTH ASIAN DEVELOPMENT THAT U.S. ASSISTANCE PROGRAMS ARE AN IMPORTANT ELEMENT OF OUR BILATERAL RELATIONSHIPS, SERVING KEY U.S. REGIONAL INTERESTS WHILE FULFILLING IMPORTANT ECONOMIC AND SECURITY NEEDS OF SOUTH ASIAN NATIONS.

MR. CHAIRMAN, BEFORE I BEGIN MY COUNTRY-BY-COUNTRY REVIEW OF OUR PROGRAMS, I WOULD LIKE TO MAKE SPECIAL NOTE OF AN IMPORTANT REGIONAL DEVELOPMENT SINCE I LAST APPEARED BEFORE THIS COMMITTEE. THIS IS THE FORMAL ESTABLISHMENT LAST DECEMBER OF THE SOUTH ASIAN ASSOCIATION OF REGIONAL COOPERATION, OR SAARC. WE SEE THIS NEW ORGANIZATION AS A NATURAL OUTGROWTH OF THE

TRADITIONALLY INTERWOVEN TIES OF THE NATIONS OF THIS REGION AS WELL AS A REFLECTION OF THE SHARED INTERESTS OF THE GOVERNMENTS AND PEOPLES OF SOUTH ASIA IN PEACE, STABILITY AND COOPERATION FOR ECONOMIC AND SOCIAL DEVELOPMENT. THE U.S. SEEKS TO BE A CONSTRUCTIVE PARTNER IN PROMOTING THESE INTERESTS, AND STANDS READY TO SUPPORT AS APPROPRIATE THE ACTIVITIES OF THIS NEW ORGANIZATION.

LET ME NOW BEGIN A BRIEF COUNTRY-BY-COUNTRY REVIEW OF U.S. ASSISTANCE PROGRAMS IN LIGHT OF OUR BASIC INTERESTS AND OBJECTIVES.

PAKISTAN. MR. CHAIRMAN, AS I NOTED EARLIER, THE PAKISTAN PROGRAM INVOLVES A NUMBER OF SPECIAL CONSIDERATIONS. LET ME NOW REVIEW THOSE CONSIDERATIONS IN SOME DETAIL.

OUR GOAL OF A SECURELY INDEPENDENT AND PROSPEROUS PAKISTAN SERVES BOTH OUR OWN INTERESTS AND THE INTERESTS OF ALL SOUTH ASIA. THIS IS EVEN MORE THE CASE NOW THAT PAKISTAN HAS RESTORED CONSTITUTIONAL GOVERNMENT. WELL BEFORE THIS WELCOME DEVELOPMENT, WE HAD CONCLUDED THAT PAKISTAN FACED UNIQUE CIRCUMSTANCES WHICH HAD SIGNIFICANT IMPLICATIONS FOR U.S. REGIONAL AND GLOBAL INTERESTS; IN 1981, THE ADMINISTRATION WITH THE ADVICE AND COUNSEL OF THE CONGRESS, COMMITTED ITSELF TO

SEEKING A $3.2 BILLION SIX-YEAR ECONOMIC AND FIVE-YEAR MILITARY ASSISTANCE PROGRAM, SPLIT EVENLY BETWEEN ECONOMIC AND MILITARY ASSISTANCE. THAT PROGRAM WHICH WILL ENTER ITS FINAL YEAR IN FY 87 HAS BEEN NOTABLY SUCCESSFUL IN MEETING ITS MULTI-YEAR OBJECTIVES. WITH THE SUPPORT OF THE CONGRESS WE HAVE CARRIED OUT OUR CURRENT ECONOMIC AND SECURITY ASSISTANCE PROGRAM AT NEAR FULL FUNDING, EXCEPT FOR CUTS MANDATED BY GRAMM-RUDMAN IN FY 86. WE HOPE TO CONTINUE THIS ACHIEVEMENT IN FY 1987. WE ARE NOW DISCUSSING A FOLLOW-ON MULTI-YEAR PROGRAM WITH THE PAKISTANI GOVERNMENT.

THE PRESSURES FACING PAKISTAN IN 1981 WHICH WARRANTED THE INITIATION OF A MAJOR U.S. ASSISTANCE PROGRAM HAVE NOT ABATED. IN FACT, DURING 1985 THESE PRESSURES INCREASED PERCEPTIBLY. SOVIET EFFORTS AT INTIMIDATION WERE STEPPED UP; CROSS-BORDER SUBVERSION AND ATTACKS FROM AFGHANISTAN INTO PAKISTAN LEFT SEVERAL HUNDRED CIVILIANS INSIDE PAKISTAN DEAD OR WOUNDED. HARSH SOVIET THREATS AIMED AT UNDERMINING PAKISTAN'S SENSE OF SECURITY CONTINUED THROUGHOUT THE YEAR AS WELL. CONFIDENT OF OUR SUPPORT, PAKISTAN HAS REMAINED STEADFAST DESPITE THESE THREATS, REFUSING TO RECOGNIZE THE SOVIET-CONTROLLED REGIME IN KABUL OR TO ACQUIESCE IN THE CONTINUING SOVIET EFFORTS TO SUBJUGATE THE AFGHAN PEOPLE.

Soviet pressure on Pakistan has increased as a consequence of Soviet frustration over its continued inability to secure the conquest of Afghanistan. Despite heightened Soviet efforts, the situation at the end of 1985 finds the Soviets no closer to defeating the Afghan resistance than they were in 1980.

Both the United States and Pakistan remain committed to seeking a negotiated settlement for Afghanistan. Our support for the UN-sponsored negotiations is on record, as is our consistently stated willingness to serve as a guarantor of a comprehensive and balanced agreement which provides for the prompt withdrawal of Soviet troops. It should also encompass the other elements in the seven resolutions which the UN General Assembly has strongly supported by overwhelming majorities each year since the December 1979 invasion.

Despite recent statements, the Soviets give no sign of a real desire for a settlement. To date, no, and I repeat, no withdrawal timetable has been tabled in the context of the UN negotiations, and we are unaware of any new Soviet thinking on this score.

The extraordinary generosity and sense of humanitarian responsibility with which the Pakistani Government and people

HAVE SHOULDERED THE EVER-INCREASING BURDEN OF MILLIONS OF AFGHAN REFUGEES DESERVES SPECIAL NOTE. THE UNITED STATES THROUGH THE UNHCR AND THE WORLD FOOD PROGRAM HELPS ALLEVIATE THE SERIOUS DRAIN ON PAKISTANI RESOURCES OF PROVIDING FOR REFUGEE NEEDS. WE ARE PLEASED THAT THE CONGRESS HAS GIVEN STRONG SUPPORT TO THIS PROGRAM.

IN VIEW OF THE SITUATION PAKISTAN FACES, WE MUST CONTINUE TO ADDRESS PAKISTAN'S URGENT NEED FOR MODERNIZATION OF ITS DEFENSE FORCES. OUR PROGRAM WILL ENABLE PAKISTAN TO CONTINUE ITS STEADY OPPOSITION TO SOVIET AGGRESSION IN AFGHANISTAN, RETAIN ITS LEADERSHIP ROLE IN THE INTERNATIONAL COMMUNITY ON THE AFGHAN ISSUE, AND CONTINUE TO HOST MORE THAN 2.5 MILLION AFGHAN REFUGEES WHILE PURSUING ESSENTIAL ECONOMIC DEVELOPMENT PROGRAMS. OUR PROPOSED ECONOMIC ASSISTANCE PACKAGE WILL WORK DIRECTLY TOWARD ASSISTING PAKISTAN'S LONG-TERM DEVELOPMENT EFFORTS IN THE IMPORTANT FIELDS OF HEALTH, POPULATION, ENERGY, AND AGRICULTURE AS WELL, AND WILL PROVIDE SHORT-TERM BALANCE-OF-PAYMENTS SUPPORT.

EQUALLY IMPORTANT, OUR ASSISTANCE HELPS TO PROVIDE THE SELF-CONFIDENCE NECESSARY FOR PAKISTAN TO PLAY ITS PART IN BRINGING ABOUT THE BETTER RELATIONSHIP BETWEEN INDIA AND PAKISTAN BOTH COUNTRIES SEEK. WE STRONGLY ENDORSE THEIR STEPS

TOWARD AN IMPROVED RELATIONSHIP BECAUSE IT IS ESSENTIAL TO SOUTH ASIAN PEACE AND STABILITY, AND IN PARTICULAR FOR AVOIDING A NUCLEAR ARMS RACE IN SOUTH ASIA. WITH LESSENED SUSPICION BETWEEN INDIA AND PAKISTAN, A MAJOR INCENTIVE DIMINISHES FOR THE DEVELOPMENT OF NUCLEAR WEAPONS.

THE PAKISTANI ECONOMY HAS SHOWN MIXED RESULTS DURING THE PAST YEAR. BUMPER AGRICULTURAL HARVESTS HAVE CONTRIBUTED TO A RETURN TO SUBSTANTIAL REAL DOMESTIC ECONOMIC GROWTH RATES AND HAVE ALLEVIATED SOMEWHAT THE PRESSURES ON PAKISTAN'S BALANCE OF PAYMENTS. UNCERTAINTIES ABOUT CONTINUING WORKERS' REMITTANCES, DEPRESSED INTERNATIONAL COMMODITY PRICES, AND A MOUNTING DEBT BURDEN, HOWEVER, HAVE KEPT PAKISTAN'S FOREIGN PAYMENTS OUTLOOK CLOUDED. WE CONTINUE TO URGE ECONOMIC POLICY REFORMS, PARTICULARLY GREATER MOBILIZATION OF DOMESTIC RESOURCES, WHICH WILL IMPROVE PAKISTAN'S LONGER TERM BALANCE OF PAYMENTS OUTLOOK AND LAY THE FOUNDATION FOR SUSTAINED HIGH RATES OF ECONOMIC GROWTH.

WE ARE HOPEFUL AND HEARTENED BY PAKISTAN'S RETURN TO ELECTED, CONSTITUTIONAL GOVERNMENT. WE BELIEVE THAT THE ASSURANCE OF OUR CONTINUED ECONOMIC AND SECURITY ASSISTANCE OVER A PERIOD OF

YEARS HELPS CREATE THE DOMESTIC CONDITIONS NECESSARY FOR CONTINUED POLITICAL EVOLUTION AND STABILITY. THIS IS ONE REASON WHY A MULTI-YEAR FOLLOW-ON PROGRAM IS CRUCIAL. IT HELPS ENSURE THAT DESPITE SOVIET SUBVERSION AND CROSS-BORDER THREATS, DEMOCRACY WILL FLOURISH IN PAKISTAN AND DURABLE POLITICAL INSTITUTIONS WILL DEVELOP.

AN IMPORTANT U.S. CONCERN ALSO SERVED BY OUR ECONOMIC ASSISTANCE IS NARCOTICS CONTROL. OVER ONE-HALF OF ALL HEROIN ON THE U.S. MARKET IS SOUTH AND SOUTHWEST ASIAN IN ORIGIN. WHILE PAKISTANI OPIUM-GROWING ACREAGE HAS BEEN REDUCED, SIGNIFICANT AMOUNTS OF HEROIN ARE PRODUCED IN AND TRANSIT THROUGH PAKISTAN. WE HAVE A WELL-ESTABLISHED PROGRAM IN PAKISTAN TO HELP ERADICATE OPIUM PRODUCTION AND SHUT DOWN HEROIN LABS, BUT THE TASK IS FAR FROM COMPLETE. OUR FY 1987 NARCOTICS PROGRAM COMBINES ECONOMIC ASSISTANCE FUNDING FOR INTEGRATED RURAL DEVELOPMENT, ALONG WITH U.S.-PAKISTANI LAW ENFORCEMENT COOPERATION AND FUNDING FOR AGRICULTURAL OUTREACH PROGRAMS TO OPIUM-GROWING REGIONS. IT IS AN EXTENSIVE UNDERTAKING, BUT THE CHALLENGE OF DRUG ABUSE IN OUR COUNTRY WARRANTS A PROGRAM OF THIS MAGNITUDE.

AS WE MENTIONED ABOVE, ANOTHER CRITICAL U.S. INTEREST SERVED BY OUR ASSISTANCE PROGRAM IS NON-PROLIFERATION. WHILE PRESIDENT

ZIA AND PRIME MINISTER JUNEJO HAVE PUBLICLY MADE ASSURANCES REGARDING THE PEACEFUL NATURE OF THE PAKISTANI NUCLEAR PROGRAM. WE HAVE CONTINUED TO CONVEY TO THE PAKISTAN GOVERNMENT ON NUMEROUS OCCASIONS AND AT THE HIGHEST LEVELS OUR CONCERNS ABOUT UNSAFEGUARDED NUCLEAR FACILITIES IN THAT COUNTRY. WE ARE CONFIDENT THAT OUR MESSAGE THAT PAKISTANI NUCLEAR RESTRAINT IS ESSENTIAL TO OUR ABILITY TO PROVIDE SECURITY ASSISTANCE HAS BEEN CLEARLY UNDERSTOOD. AS THE PRESIDENT CERTIFIED TO THE CONGRESS LAST FALL, WE DO NOT BELIEVE THAT PAKISTAN POSSESSES A NUCLEAR DEVICE. WE ARE CONVINCED, AS WELL, THAT OUR PROGRAM OF SECURITY ASSISTANCE HAS CONTRIBUTED AND WILL CONTINUE TO CONTRIBUTE SIGNIFICANTLY TO REDUCING THE RISK THAT IT WILL.

WHILE WE WILL CONTINUE TO DO ALL WE CAN TO RESTRAIN THE PAKISTANI PROGRAM, AND OUR ABILITY TO PROVIDE SECURITY ASSISTANCE IS ESSENTIAL IN THIS REGARD, WE ALSO RECOGNIZE THAT THE NUCLEAR ISSUE IN SOUTH ASIA IS REGIONAL IN NATURE. INDIA, WHICH EXPLODED WHAT IT CALLED A PEACEFUL NUCLEAR DEVICE IN 1974, OPERATES A SIGNFICANT NUMBER OF UNSAFEGUARDED NUCLEAR FACILITIES. DEEP-SEATED MUTUAL DISTRUST CHARACTERIZES THE RELATIONSHIP BETWEEN INDIA AND PAKISTAN. ACCORDINGLY, THE BEST PROSPECT FOR A LASTING SOLUTION TO THE SOUTH ASIA NUCLEAR ISSUE LIES IN A DIALOGUE BETWEEN INDIA AND PAKISTAN THAT LEADS TO SIGNIFICANT NONPROLIFERATION STEPS BY BOTH, AND IN AN OVERALL

REDUCTION OF INDO-PAKISTANI TENSIONS. LAST DECEMBER 17, PRESIDENT ZIA AND PRIME MINISTER GANDHI AGREED IN PRINCIPLE TO A MUTUAL PLEDGE NOT TO ATTACK EACH OTHER'S NUCLEAR FACILITIES. THIS AGREEMENT IS A WELCOME FIRST STEP THAT WE URGE BOTH SIDES TO FOLLOW-UP WITH ADDITIONAL MEASURES. PRESIDENT ZIA HAS STATED THAT HIS GOVERNMENT IS PREPARED TO UNDERTAKE, JOINTLY WITH INDIA, ACCESSION TO THE NPT OR ACCEPTANCE OF FULL-SCOPE IAEA SAFEGUARDS, MUTUAL INSPECTION OF EACH OTHER'S NUCLEAR FACILITIES, A JOINT DECLARATION RENOUNCING ACQUISITION OR DEVELOPMENT OF NUCLEAR WEAPONS, OR ESTABLISHMENT OF A NUCLEAR WEAPONS FREE ZONE. HE HAS ALSO STATED THAT HE IS READY TO DISCUSS ANY PROPOSALS THE GOVERNMENT OF INDIA MIGHT TENDER. PAKISTANI (AS WELL AS INDIAN) RESTRAINT IN THE NUCLEAR AREA, AND PAKISTANI CONFIDENCE IN THE SECURITY ASSISTANCE RELATIONSHIP WITH THE US, ARE ESSENTIAL ELEMENTS IN CREATING A CONTEXT CONDUCIVE FOR A NUCLEAR DIALOGUE THAT LEADS TO MAJOR CONCRETE NONPROLIFERATION STEPS.

## AFGHANISTAN CBA

THE CROSS BORDER HUMANITARIAN ASSISTANCE (CBA) PROGRAM ADMINISTERED BY THE AGENCY FOR INTERNATIONAL DEVELOPMENT ASSISTS WAR-AFFECTED AFGHAN CIVILIANS LIVING INSIDE AFGHANISTAN TO MEET URGENT HEALTH AND OTHER NEEDS WHILE ENCOURAGING THEM TO

REMAIN IN AFGHANISTAN, THEREBY STRENGTHENING THE POPULAR BASE OF THE RESISTANCE. THE CBA PROGRAM WILL ALSO INCREASE THE LIKELIHOOD THAT REFUGEES NOW LIVING IN PAKISTAN WILL EVENTUALLY RETURN HOME. TO UNDERWRITE THE DELIVERY OF HEALTH AND EDUCATIONAL SERVICES, PROMOTE AGRICULTURAL PRODUCTION (INCLUDING LIVESTOCK MANAGEMENT AND VETERINARY SERVICES), AND COMMODITY SUPPORT. AID INTENDS TO PROVIDE $14.355 MILLION OF ECONOMIC SUPPORT FUNDS EARMARKED FOR THIS PURPOSE BY CONGRESS IN THE FY86 FOREIGN ASSISTANCE ACT AND THE ADMINISTRATION IS REQUESTING $15 MILLION FOR FY 87. THE OFFICE OF THE AID REPRESENTATIVE FOR AFGHANISTAN AFFAIRS IN THE U.S. EMBASSY IN ISLAMABAD IS OVERSEEING THE PREPARATION OF DETAILED PLANS FOR IMPLEMENTING PROJECTS IN THESE PRIORITY AREAS; PROGRAM IMPLEMENTATION BEGINS IN THE SPRING. SUCH PROJECTS WILL NOT SUPPLANT OUR CONTINUING SUPPORT FOR MANY PROJECTS RUN BY PRIVATE VOLUNTARY ORGANIZATIONS; THE EXACT MEANS OF ADMINISTERING THESE PROGRAMS REMAINS TO BE WORKED OUT, THOUGH OUR INTENTION IS TO WORK CLOSELY WITH THE AFGHAN RESISTANCE ALLIANCE.

## INDIA

INDIA IS THE DOMINANT REGIONAL POWER IN SOUTH ASIA, AND PLAYS A PIVOTAL ROLE IN REGIONAL PEACE AND STABILITY. OVER THE YEARS, OUR RELATIONSHIP HAS EVOLVED FROM ONE IN WHICH BILATERAL ECONOMIC ASSISTANCE PLAYED A MAJOR ROLE TO ONE WHICH PLACES GREATER EMPHASIS ON JOINT COLLABORATION BETWEEN OUR TWO OPEN, DEMOCRATIC SOCIETIES. THAT COLLABORATION IS EPITOMIZED BY THE INDO-U.S. JOINT COMMISSION, WHICH MET LAST MONTH WHEN THE FOREIGN MINISTER VISITED WASHINGTON, AND BY THE SUBCOMMISSIONS ON ECONOMIC AND COMMERCIAL RELATIONS, AGRICULTURE, SCIENCE AND TECHNOLOGY, AND EDUCATION AND CULTURE.

OUR AID PROGRAM IN INDIA IS NOW SMALL IN COMPARISON TO INDIA'S TOTAL DEVELOPMENT NEEDS AND FOCUSES ON AREAS WHICH BOTH WE AND THE GOVERNMENT OF INDIA CONSIDER CRUCIAL: AGRICULTURE, INCLUDING IRRIGATION AND FORESTRY, HEALTH AND FAMILY PLANNING, ALTERNATIVE ENERGY RESOURCES AND PRIVATE SECTOR DEVELOPMENT. THE MAJOR TARGET OF THE PROGRAM IS THE ESTIMATED 300 MILLION INDIANS, OR 40% OF THE POPULATION WHICH FALLS BELOW THAT COUNTRY'S POVERTY LINE. MOST OF THESE ARE RURAL POOR. IN SEEKING TO REDUCE THIS GRINDING POVERTY, THE AID PROGRAM EMPHASIZES APPLICATION OF RELEVANT SCIENCE AND TECHNOLOGY TO KEY DEVELOPMENT PROBLEMS IN SUCH AREAS AS AGRICULTURAL RESEARCH AND VACCINE DEVELOPMENT.

IN THIS RESPECT, THE AID PROGRAM MIRRORS THE BROADER INDO-U.S. RELATIONSHIP, WHERE HIGH TECHNOLOGY HAS BECOME A KEY ELEMENT OF

BOTH SCIENTIFIC COLLABORATION AND TRADE. TRADITIONALLY STRONG TIES BETWEEN OUR SCIENTIFIC COMMUNITIES HAVE BEEN ENHANCED THROUGH THE SCIENCE AND TECHNOLOGY INITIATIVE, BEGUN IN 1982 AND EXTENDED DURING PRIME MINISTER RAJIV GANDHI'S VISIT TO WASHINGTON LAST JUNE. THE PURPOSE OF THE STI, WHICH IS SUPPORTED IN PART BY AID, IS TO CONCENTRATE ON A FEW AREAS OF RESEARCH OF GREAT POTENTIAL BENEFIT TO BOTH COUNTRIES. INDO-US TRADE IN HIGH TECHNOLOGY ITEMS HAS BEEN SITIMULATED BY NEGOTIATION OF A MEMORANDUM OF UNDERSTANDING TO PROTECT THAT TECHNOLOGY. THIS SHOULD HELP PRESERVE OUR POSITION AS INDIA'S LEADING PARTNER IN BOTH TRADE AND BUSINESS COLLABORATIONS. AID WILL PLAY AN IMPORTANT ROLE THROUGH ITS COMMITMENT TO PROVIDE A $7 MILLION (ESF) GRANT TO HELP MEET EUROPEAN CONCESSIONAL FINANCING TERMS IN A STIFF COMPETITION FOR A CONTRACT TO MANUFACTURE SMALL MAIN FRAME COMPUTERS IN INDIA. AN AMERICAN FIRM WON THE CONTRACT, WHICH SHOULD RESULT IN $500 MILLION IN DIRECT SALES AND A POTENTIAL OF EVEN MORE INDIRECT SALES.

INDIA HAS UNDERTAKEN AN AMBITIOUS ECONOMIC LIBERALIZATION PROGRAM WHICH SEEKS TO BEGIN THE ARDUOUS TASK OF DISMANTLING THE STIFLING MASS OF REGULATIONS WHICH CONSTRAIN THE POTENTIAL DYNAMISM OF THE INDIAN ECONOMY. WE HAVE LITTLE DIRECT ROLE IN THIS PROCESS, BUT HAVE AUTHORIZED ONE $11 MILLION GRANT TO FINANCE SUB-PROJECTS FOR INDO-U.S. INDUSTRIAL R & D DESIGNED TO

HELP MODERNIZE INDIA'S PRIVATE SECTOR SO IT CAN RESPOND MORE EFFECTIVELY TO LIBERALIZATION MEASURES. WE APPLAUD THE INTENT OF LIBERALIZATION AND ARE BOTH ENCOURAGING AMERICAN COMPANIES TO LOOK AGAIN AT THIS STABLE, DEMOCRATIC COUNTRY, AND SEEKING ADDITIONAL WAYS OF ENCOURAGING THE PRIVATE SECTOR THROUGH OUR DEVELOPMENT ASSISTANCE PROGRAM.

## BANGLADESH

OUR ASSISTANCE SERVES A TWOFOLD ECONOMIC PURPOSE IN BANGLADESH: TO INSURE THAT IN THIS NATION OF 100 MILLION, BASIC HUMAN NEEDS ARE MET, ESPECIALLY THE PROVISION OF AN ADEQUATE FOOD SUPPLY, AND TO HELP ESTABLISH CONDITIONS WHICH WOULD PROVIDE FOR SUSTAINABLE ECONOMIC GROWTH. WE CONCURRENTLY SEEK TO ENCOURAGE LONG-TERM POLITICAL STABILITY UNDER REPRESENTATIVE INSTITUTIONS.

GIVEN BANGLADESH'S EXTREMELY LOW PER CAPITA INCOME AND ENORMOUS NEEDS, OUR ASSISTANCE IS ENTIRELY GRANT. OUR STRATEGY IS AIMED AT REDUCING FERTILITY, INCREASING AGRICULTURAL PRODUCTION, AND GENERATING RURAL EMPLOYMENT. THIS BASIC STRATEGY IS ACCOMPANIED BY AN ACTIVE POLICY DIALOGUE IN CONCERT WITH OTHER DONORS. PARTICULAR EMPHASIS HAS BEEN PLACED ON STRENGTHENING THE ROLE OF MARKETS AND INCREASING THE PRIVATE SECTOR to be concerned with conditions in the real estate market, with the policies and practices that have been and are being followed by financial institutions in making real estate loans and with the procedures the federal agencies are following in supervising such activities.

As this Committee is well aware, important areas of the nation's real estate market are currently experiencing serious difficulties and are creating problems of varying degrees of severity for our financial institutions. The most dramatic situation can be found in the market for farm land, where, given the generally depressed condition of our farm sector, prices in many areas have dropped very sharply over the past couple of years. As a result, land owners have generally experienced a substantial decline in their wealth, and, unfortunately, in all too many cases have been unable to service their mortgage indebtedness. Thus, financial institutions, too, have incurred large losses.

Serious strains have also developed in the commercial real estate markets, particularly for office buildings, in many cities of our country. Construction of office space has been outpacing demand for several years now, and office vacancy rates have been rising. These developments have been most apparent in a number of the sunbelt cities that experienced boom conditions in the late 1970's and early 1980's, but also can be increasingly found in a number of other cities. Moreover, incoming data continue to suggest that the situation in many cities may be getting worse as construction of new office space continues to outpace the rate of its absorption. Thus vacancy rates have continued to rise, in many cases to levels unprecedented in the post World War II period, and developers have been unable to get their buildings leased up sufficiently either to promote their sale or to meet the servicing requirements on construction loans. As a consequence lenders in all too many cases have either become unexpected owners of buildings with much empty office space or found it necessary to renegotiate loans to lengthen their maturity and provide additional funds to support the leasing efforts of the developer.

Mr. Chairman, relevant to today's hearing, the important question that needs to be answered with regard to these conditions is the extent to which they can be attributed to faulty or fraudulent property appraisals. I have little doubt that there have been cases in both the market for farm land and for commercial properties in which loans have been made based on fraudulent or faulty appraisals. Human nature being what it is, that would seem to be unavoidable. But I do not believe that the problems are primarily or even largely traceable to such appraisals. Farm land appraisals that now appear to be much too high, for example, were made when there were boom conditions in the market and it was a common view that land prices would continue moving up as they had over a long preceding period. One cannot expect those appraising property to be better at forecasting a sharp change in ecomomic conditions than others in the market place.

Much the same kind of economic dynamics accounts for the fact that property appraisals in the commercial real estate market also now appear unrealistically high in many cases. The long period of inflation recorded in the late 1960's and over the 1970's affected, and to some degree continues to affect, the thinking of participants in this market. Over that period the general experience was that, if not seriously flawed in design or construction, real estate projects would eventually prove to be profitable. Thus, the view developed -- and still continues to be expressed today -- that while a newly constructed building might remain considerably under-occupied for a time, eventually inflation along with growth of the local economy, would assure its sale at a price that provides a profit for the developer as well as the full repayment of loans that financed the project. But while widely held, this view has clearly been proven to be wrong as inflation has been brought under control and growth of local economies has slowed. Here again, however, the failure of appraisals to hold up appears traceable not primarily to fraud or faulty procedures but to the sharp shift in market conditions that was unexpected by appraisers as well as a great many other market participants.

Having offered that general judgment, however, let me go on to say that it is now necessary for developers, lending institutions, investors and appraisers to recognize that economic conditions have clearly changed, and to incorporate that fact into the assumptions on which property values are bas~~ed. It~~ is my understanding that such a process is beginning to be clearly evident in the appraisals that are being made for new construction projects. That, I must say, appears to have taken a good long while, but experience suggests that expectations -- which are generally based heavily on extrapolation of past trends -- are slow to change. In addition to influencing appraisals for new property, however, it is equally important that the shift in current economic conditions and the outlook for future conditions be properly taken into account in reviewing appraisals that were formulated at earlier times on older properties under more optimistic conditions. More specifically, it is necessary for lending institutions observing that a building has failed to lease up or is leasing up only after substantial concessions not to continue to rely on an appraisal based upon the assumptions that more favorable conditions would prevail. That is to say, while an appraiser and a banking institution should not be expected to "call" a marked turn in economic conditions, it is most reasonable to expect that, once it is clear that such a turn has occurred, it be quickly recognized.

There is, of course, as I have indicated, a time gap between when circumstances first change and when that begins to significantly offset the expectations of market participants. There is good reason to expect, then, that as time goes by, institutions will become increasingly inclined to revise overstated appraisals to make them more consistent with conditions.

In order to speed that process, however, and thus achieve a clear picture of the true state of real estate loan portfolios, the federal banking agencies have developed guidelines that will work to formalize and help promote uniformity in procedures followed in classifying problem real estate loans. An important element of these guidelines is that the appraisals of property underlying real estate loans will be carefully questioned and when it appears that the property is over-appraised, to require a bank either to adjust down the appraisal immediately or have the property reappraised by an independent appraiser. Obviously when this process results in a reduction in the estimated value of the property supporting a loan, it may be necessary for the examiner to classify the loan, to require the bank to add to its loan loss reserve, and in some cases to require the recognition of loss, where appropriate. The Federal Reserve is now in the process of field testing these guidelines with the intention of eventually adopting them.

In addition to this initiative, Mr. Chairman, the Federal Reserve is undertaking a program to enhance its general supervisory activities, and this will have important implications for identifying and correcting problems in the real estate loan portfolios of the banking organizations we supervise. I will not take the time to recount that entire program here today, but would report that one of its important elements will be to generally increase the frequency by which examinations of state member banks and inspections of bank holding companies are conducted. We hope and expect to enlist the participation of state banking departments in carrying out this new frequency, but in all cases it is our intention to ensure that all state member banks and all but the smallest bank holding companies are examined at least once each year. Moreover, in conducting these examinations and inspections we intend to intensify our scrutiny of loan portfolios, including real estate loans.

Mr. Chairman, as I have reviewed, there are serious problems in certain areas of the real estate market today that are posing problems of greater or lesser severity for depository institutions. I would conclude by saying that the Federal Reserve is taking steps which we deem appropriate and necessary to address these problems.

# ATTACHMENT TO STATEMENT OF

WILLIAM TAYLOR, DIRECTOR

DIVISION OF BANKING SUPERVISION AND REGULATION

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

BEFORE THE

SUBCOMMITTEE ON

COMMERCE, CONSUMER AND MONETARY AFFAIRS
OF THE COMMITTEE ON GOVERNMENT OPERATIONS

HOUSE OF REPRESENTATIVES

DECEMBER 12, 1985

## Introduction

The following are responses to questions submitted by the subcommittee in its letter of December 5, 1985, requesting the testimony of William Taylor, Director of the Board's Division of Banking Supervision and Regulation, on December 12, 1985, at the subcommittee's hearings on faulty and fraudulent real estate appraisals. The subcommittee should also refer to related information previously provided by the Federal Reserve in response to Chairman Barnard's letter of November 4, 1985.

Question A. Federal Reserve System's Supervisory Experience

Although there are, no doubt, some appraisers that issue fraudulent reports to commercial banks, we suspect that most appraisal problems stem from faulty assumptions from incomplete or inadequate analysis by both appraisers and financial institutions and from appraisals becoming outdated and no longer consistent with prevailing economic conditions rather than from fraud. The nature of the overall problem in the industry is that faulty appraisals can lead to poor credit decisions when properties are appraised at values that exceed their "true" worth. When the appraisal value of collateral exceeds its true worth, the indicated level of protection for the loan provided by the collateral is illusory and traditional standards of credit worthiness based on collateral values, such as loan-to-value ratios, are compromised.

The impact of faulty and fraudulent appraisals is that loan losses in the banking industry are probably higher than would be the case if all loans were made on the basis of conservative appraisals. The over-appraisal of collateral may cause a financial institution to make a larger loan than warranted and this increases the magnitude of loss in the event of default by the borrower. Absent a good quality control procedure, a bank may not discover an overvaluation until a loan goes into default and the property is sold or reappraised. As a result, when loans go into default and the collateral backing the loan proves insufficient to cover the loss of principal, the bank may find that its loan loss reserve is inadequate. Should a number of sizeable loans go bad at the same time, and the bank does not have sufficient earnings and capital to absorb the losses, the bank could fail.

The examination process is designed to identify and address deficiencies in individual banking organizations and, the findings of such examinations are not routinely aggregated for groups of banks. Thus, systemwide data on the number of faulty or fraudulent appraisals is not readily available. However, based upon a survey, necessarily conducted within a very limited time frame, of the Reserve Banks specified in your letter, we have identified only two situations believed to involve fraudulent appraisals. Banking organizations whose appraisal procedures are considered inadequate are criticized and, if corrective steps are not taken by management, formal enforcement action is taken by the Federal Reserve. Such actions may require the bank to revamp its lending administration and collection procedures and, if warranted, to retain the services of an independent appraiser to conduct an evaluation of loan collateral. It should be stressed that many of the real estate lending problems stem from changed economic, financial, and demographic conditions that undermine valid appraisal assumptions. It would, of course, be incorrect to attribute such problems to fraudulent or faulty appraisals.

## Question B. Policies Concerning Appraisals

### B1. Existence of Appraisals

The Federal Reserve considers the establishment by financial institutions of a written policy for real estate lending to be an extremely important element of successful real estate lending activity. The lending policy should contain a general outline of the scope and limits of the bank's real estate credit function and the procedures for obtaining appraisals of collateral values, advancing funds, servicing loans, and collecting problem credits.

A bank's lending policy should outline where the responsibility for obtaining accurate appraisals lies and should define standard appraisal procedures including procedures for possible reappraisals in the case of renewals of extensions of credit. Acceptable types of appraisals and limits on the dollar amount and type of real estate that bank personnel are authorized to appraise should be outlined. Circumstances requiring appraisals by qualified, independent appraisers also should be described. The ratio of loan amount to appraised value, the method of collateral valuation and the allowable difference in these guidelines for various types of property should also be detailed.

Examination procedures as described in the Commercial Bank Examination Manual (Sections 215 and 216), require that examiners evaluate the adequacy of the real estate loan policy and test check compliance with the policy. Deficiencies noted by examiners, including those involving appraisals, are cited as exceptions in the examination report, with corrective action requested. Such action has included a requirement that independent outside appraisers be retained to reappraise the collateral backing a real estate loan.

Decisions by bank lending officers on loans secured by real estate should be and are heavily affected by appraisals. Thus the bank and its supervisors should assure that appraisals are accurate, a condition that depends on the integrity of the appraiser and his/her expertise in developing and interpreting pertinent data. Misrepresenting or misinterpreting data utilized in the appraisal process, whether intentional or not, could lead to significant overvaluation of property securing real estate loans and a corresponding increase in loss exposure to the financial institution.

### B2. Appraisals Required by Regulation

The real estate lending activities of state member banks are controlled by the various statutes and regulations of the chartering states which generally establish maximum loan to value ratios and maturities for real estate loans. The Federal Reserve supervises real estate lending practices through the examination process by requiring compliance with these laws and regulations, as well as with applicable prudential standards. In this regard, it is the policy of the Federal Reserve that appraisals are essential features of a sound real estate loan operation. Real estate lending that is not based on current, reliable appraisals of the underlying property is considered to be an unsafe and unsound practice. The Federal Reserve trains its examiners to review loan documentation, and, if loans are not supported by adequate appraisals, the examiner will criticize credit administration in general, cite the particular loan for lack of proper documentation, criticize the credit quality of the loan, and bring the matter to the attention of the board of directors. If the situation is not corrected, the Federal Reserve will take formal enforcement action, including the issuance of a cease and desist order requiring, among other remedial steps, that the banking organization obtain independent and timely appraisals.

We believe that we have sufficient authority to require a banking organization to take affirmative action to correct deficiencies, including those involving the adequacy of appraisals. This authority, together with the enforcement of state laws and prudent banking practices, obviates the need for a federal regulation that would apply across the board to all banking organizations.

B 3. Examination Authority to Require Reappraisals

While examiners are not authorized to require appraisals, they do, as noted, review the adequacy of loan policies and documentation, including the adequacy of appraisals. If deficiencies or weaknesses are found, examiners will request that appraisals or reappraisals be conducted by an independent, qualified appraiser. Failure on the part of a banking organization to abide by a request for reappraisal could lead to the issuance of a cease and desist order. As indicated in response to Question B 2., the Federal Reserve in issuing a cease and desist order can require institutions whose policies are inadquate or that have large exposures to retain independent appraisers to evaluate collateral.

As it pertains specifically to holding company mortgage banking subsidiaries, Section 307 of the Bank Holding Company Supervision Manual instructs the examiner to adjust outdated appraisal data, using "information sources available" (e.g., tax assessment appraisals, discussions with management etc.). As already indicated, banking organizations are, as a matter of sound banking practice, expected to have current appraisals on file. Thus, if appraisals are believed by our examiners to be substantially overvalued, or the appraisal is obsolete or the validity of the appraisal is in question, our examiners are expected to analyze the value of the collateral and, if necessary, request an outside reappraisal. Failure to comply with their request or to satisfy other documentation requirements would lead to the issuance of a cease and desist order.

### B 4. Appraiser's Qualifications

The Federal Reserve in conducting examinations and inspections checks to determine that banking institutions are using qualified appraisers. With respect to an institution's selection of appraisers, examiners consider the following:

1. The professional certification, license, or other recognition of the competence of the appraiser. Appraisals should generally be prepared and signed by an appraiser who is a member of either the Society of Real Estate Appraisers of the National Association of Realtors (Senior Real Property Appraiser or Senior Real Estate Appraiser), or the American Institute of Real Estate Appraisers ("MAI").
2. The reputation and standing of the specialist in the view of his peers and others familiar with his capability or performance.
3. The relationship, if any, of the appraiser to the institution--to determine independence and objectivity.

The real estate appraisal associations mentioned above are self-regulatory in nature and are responsible for monitoring the appraisal practices of their members. The Federal Reserve supports the efforts of these bodies to ensure high quality and professionalism in the conduct of appraisals. However, in the absence of evident deficiencies, Federal Reserve examiners generally do not go beyond these criteria in evaluating appraisers.

The Federal Reserve is in the process of revising its Commercial Bank Examination Manual and its Bank Holding Company Supervision Manual. These publications will include expanded information that helps examiners evaluate the qualifications of real estate appraisers and will provide descriptions and objectives of their self-regulating associations which have adopted a Code of Ethics or Standards of Professional Practice and Conduct. In addition, the Federal Reserve participates actively in the Examination Council's training courses on income property lending and appraisals which focus attention on evaluating appraisers and appraisals.

### B 5. Out-of-Area Lending

Some financial institutions have considerable activity in out-of-area lending. These loans are advanced on both a direct basis and indirectly as participations. It is imperative that financial institutions involved in out-of-area lending have in their possession all requisite information necessary to make an independent, informed credit decision. Examiners review out-of-area real estate loans in the same manner as all other loans to determine that the financial institution understands the risks involved and has established adequate policies, procedures, and controls to protect its position as lender.

Out-of-area real estate lending, when the financial institution does not possess the management expertise, policies, procedures and controls required to minimize attendent risks, is considered an unsafe and unsound banking

Our policy dialogue and project activity support a growing economy. Economic performance in Pakistan during 1984-85, set a record for GDP growth at 8.4 percent. Agriculture led the way with 9.9 percent growth based mainly on a record cotton crop. The high level of GDP growth represents a recovery from the previous year's depressed performance of 3.4 percent which reflected, in part, a massive failure in the cotton crop. However, increased production was not matched by higher export performance or increased public revenues and the country's balance of payments position deteriorated markedly.

Pakistan continues heavy expenditures relating to the presence of more than two million Afghan refugees and the modernization of its defense capabilities.

Overall annual growth has averaged better than six percent in recent years, which is very good. Favorable weather and the beginnings of a process of economic liberalization have allowed Pakistan to continue its overall economic growth. Over the medium term, however, the Pakistan government will need to address the intensifying balance of payments difficulties, sluggish export growth, reduced remittances from overseas Pakistanis employed mainly in the Gulf, and continued weak domestic resource mobilization.

## India

We are requesting $72 million DA and $80.5 million P.L. 480 Title II for India. The India program is particularly innovative. It emphasizes agricultural modernization, renewable resources management and development, voluntary family planning and child survival, and science and technology for development. The irrigation and forestry portfolios exemplify our emphasis on institution building. Technology transfer pervades the irrigation, forestry, agricultural research, industrial research and development, and biomedical programs. The Title II program focuses on oilseeds development through cooperatives, nutrition education, rural employment generation, and increased agricultural production. Before describing the RY 1987 program more specifically, I would like to comment upon the larger economic context within which our program operates.

In Indian FY 1984-85, real GNP increased 3 percent to provide a per capita income of $251. Agriculture production did not exceed 1983-84 levels, registering zero growth against population growth of 2.1 percent. Industrial production grew by 5.5 percent in the same period. The annual inflation rate was 9 percent.

India's balance of payments turned a small surplus with reserves affording a five months import cover. The debt service ratio was 15 percent of current earnings, and is expected to mount rapidly over the next few years as large IMF repayments come due. The problem will be exacerbated by a leveling off of domestic oil production and resultant increases in oil imports, plus a general expansion in imports in response to economic liberalization measures.

These measures were instituted by Prime Minister Gandhi to stimulate modernization and improve productivity, as part of the effort to achieve the 5 percent annual GDP growth target of the Seventh Development Plan. This growth target is considered by the Indian Government to be the minimum essential level required to raise chronically low per capita incomes, and reduce the numbers of people living below the poverty line (currently about 40 percent of the population).

During Fiscal Year 1987, A.I.D. will continue to support agricultural modernization aimed at increasing the incomes of the rural poor by introducing new integrated approaches to land and water design and management in selected states; strengthening state-level water management institutes; training personnel in management principles and appropriate technology for forestry management, education, and research;

and supporting forestry research and state-level social forestry projects, and improved central government policy guidance on forestry issues.

AID will intensify support for agricultural research by associating with selected components of the All-India Coordinated Research Program and by working with selected state governments in programs of technical collaboration.

We will continue to assist in developing, expanding, and improving the quality of health service and child survival programs which include oral rehydration therapy, child immunizations, family-planning spacing methods, and nutritional improvements which, together, have the highest potential for reducing infant and child mortality rates. Funding will also continue to support the creation of an epidemiological network in India.

PL 480 Title II resources will be used to support oilseeds development through cooperatives; Food-For-Work; and maternal/child health and school feeding programs operated by PVOs such as CARE and CRS.

Bangladesh

We are requesting $75 million in Development Assistance, $64 million in PL 480 Title III and $16.3 million in Title II assistance for Bangladesh. Our strategy is aimed at reducing fertility, increasing agricultural production, and generating rural employment. Basic to this strategy is an active policy dialogue with particular emphasis on strengthening the role of markets and increasing the scope of private sector participation in the economy. The broad impact of AID's programs in Bangladesh can be measured best by important policy changes, which have been supported by substantial U.S. assistance.

Economic performance in FY 1985 improved in some respects over FY 1984, particularly in foodgrain production, but weakened markedly in other areas. Real GDP rose approximately 3 percent over FY 1984, roughly keeping pace with the population increase, which means that per capita income did not rise. With good management, foodgrain production increased 4.3 percent, despite floods and drought.

On the other hand, in contrast to 5 percent growth in 1984, industrial production rose only 3.4 percent in 1985; further softening is expected in early 1986. Rapid monetary expansion, declining remittances, worsening terms of trade and increased debt repayments put additional pressure on foreign exchange reserves. Export prospects for 1986 are more uncertain than last year for jute, tea and garments.

In light of balance of payments difficulties, the Government succcessfully negotiated a $190 million standby arrangement with the IMF. The Third Five Year Plan, issued by the Bangladesh Government in November 1985, proposes somewhat optimistic targets but reinforces the Government's intent to continue privatization policies and increase industrial investment.

In response to donors' urging, the Government of Bangladesh has taken measures to control credit expansion, reduce subsidies, reduce administrative controls on some prices, raise utility rates, liberalize the trading system, and undertake exchange rate reforms. AID has supported major economic reforms undertaken by the Bangladesh Government over the last few years, including:

-- Complete overhaul of foodgrain pricing and marketing systems. This effort is supported by PL 480 Title III commodities;

- -- Denationalization and decontrol of fertilizer sales; and

- -- Revision of the interest rate structures and management improvements in the rural banking system to reduce subsidies, improve the loan recovery rate, and promote more effective lending by rural banks. U.S. development assistance has supported these important changes.

In our FY 1987 program, we plan to provide funds for new and ongoing activities including:

- -- Continued support for government and private family planning service delivery programs and for demand creation initiatives;

- -- Support to strengthen Bangladesh's agricultural and forestry research system;

- -- Pursuit of a new multi-year PL 480 Title III program to improve foodgrain and agricultural policies;

- -- Continued provision of such rural infrastructure as farm-to-market roads and electricity;

- -- Continued efforts to promote small, labor-intensive enterprises;

- -- Continued privatization of fertilizer distribution through a national wholesale network;
- -- Support to provide quality in-country and U.S. training in public administration, management, business administration and economics; and
- -- Assistance to NGOs to provide more maternal and child health services.

### Sri Lanka

The request for this program is $20 million in DA, $19 million for PL 480 Title I and $2 million for Title II. The program is aimed at expanding food production, increasing capacity to generate and increase incomes, and improving human productivity and quality of life. Projects are concentrated in agricultural and rural enterprise development, health, nutrition, and housing.

The FY 1987 program in Sri Lanka will shift to an almost exclusive focus on rural development in seeking to increase agricultural productivity and farm incomes and to provide opportunities for off-farm employment and rural enterprises. For example, the Irrigation Systems Management project will continue work on improving the operations and maintenance capabilities for major irrigation systems while simultaneously helping to rehabilitate selected systems.

Planning, evaluation and management improvement are highlighted in the Agricultural Planning and Analysis project and the Development Management and Training project. The new Rural Enterprise Development project will stimulate rural enterprise development linked to major irrigation systems and settlement schemes in Sri Lanka, especially in the Mahaweli River Basin. The project will include a wide range of private enterprise development activities. Emphasis will be on the removal of constraints faced by the private sector.

Food assistance provided through the PL 480 Title I program will contribute to reducing Sri Lanka's food supply gap while supporting the Government's national agriculture, food and nutrition strategy and related policies. Voluntary agency Maternal/Child Health programs supported through the PL 480 Title II program will continue. However, school-feeding programs will be phased out during the year.

These sectoral efforts take place within a difficult economic context. Sri Lanka's GDP grew by less than 5 percent in 1985; this is well below 1984's performance. Tea production was about the same as for 1984 but international prices have been declining. The coconut industry staged a marked recovery, attributable to favorable weather and the increased use of fertilizer. The outlook for tourism remains bleak due to the unsettled security situation.

On the other hand, garment exports performed strongly in the face of growing import restrictions in developed country markets. Budget and balance of trade deficits both continued to expand and public debt increased substantially. The 1986 budget introduced significant tax and tariff revisions to reduce fiscal imbalances, non-essential imports, and boost exports.

## Nepal

The $14.4 million DA program is directed to humanitarian and development needs with project emphasis on agricultural and rural development, water management, arresting environmental degradation, and family planning, health, and teacher training. These are AID's priority areas for developing one of the poorest countries in the world.

In terms of agricultural productivity, the Institute of Agriculture and Animal Science follow-on project helps to build capacity to train professional agriculturalists and extension agents. By the end of FY 1987, the Institute will be graduating some 480 students annually. The Agricultural Research and Production project, focused primarily on chronic food deficit hill areas, will continue to support improved national agricultural research, extension, and seed supply systems. More efficient use of vital water resources for agriculture will be supported through the Irrigation Management project by developing training and service units for operation and maintenance in the Government's irrigation department.

The Resource Conservation and Utilization (RCU) project is probably the largest field effort in Nepal focused primarily on resource conservation. The program concentrates on field activities in forestry, erosion control and land use management. The new Institute for Renewable Natural Resources project will assist development of a school for advanced training in forestry, natural resource conservation and related disciplines. As the Rural Area Development - Rapti Zone project phases out, a new Rapti Development effort will be initiated focused primarily on agriculture and forestry production.

In population and health, the Integrated Rural Health/Family Planning project will promote expansion of a successful contraceptive retail sales program and test contraceptive marketing techniques in village settings. The project will also build on initiatives begun earlier with Child Survival Funds in assisting promotion of oral rehydration therapy, and and reduction of child deaths from respiratory diseases. At the same time, the PVO Co-Financing project will assist U.S. private voluntary organizations and their Nepalese counterparts in implementing small, but high impact programs in population and health.

The AID program in Nepal assists a country facing major economic problems. Nepal's economy continues to stagnate. Agricultural production, which contributes 60 percent to GDP, which constitutes 75 percent of exports and employs 90 percent of the work force, is almost totally dependent on climatic factors. Poor monsoons again inhibited growth of agricultural output and real GDP growth in 1984-85. This followed an economic rebound in 1983-84 after a severe drought in 1982-83.

Nepal's balance of payments has deteriorated sharply, resulting in substantial losses of foreign exchange to cover the deficits. Underlying the strong import demand pressures were the government's strong expansionary fiscal management policies in the face of weak revenue performance. A $20 million IMF standby negotiated in December 1985 aims at reversing the current balance of payments slide by 1987. However, sharply reduced prices for imported oil may cause a turn-around to occur in 1986.

## Afghanistan

The $15 million ESF requested provides humanitarian support to Afghan victims of the Soviet occupation. Funding priorities have been established to: (a) support education and health programs inside Afghanistan; (b) improve agricultural production, including livestock management and veterinary services; and (c) provide commodity support.

Private voluntary organizations, U.S. based or other, are expected to play a significant role in implementing the AID program. Another key element of the AID approach is encouragement of continued and expanding humanitarian assistance from European and other western and non-aligned donors.

# ANE BUREAU MANAGEMENT INITIATIVES

## Reorganization

In May 1985, AID's Bureau for Asia and Bureau for the Near East merged into a single unit, the Asia and Near East Bureau (ANE). The initial job of combining two organizations with different operating systems, program emphases, strengths, problems, and staff has been substantially accomplished.

The reorganization with accompanying staff reductions has increased the need for efficiency measures, such as expanded use of automation, centralization of similar functions, integrated technical support, and added delegations to the field, in order to make the best use of the available workforce.

## Evaluation and Financial Management

The merger of the former Asia and Near East bureaus presented a unique opportunity to bring together the best evaluation features of both bureaus. Central to each bureau was the use of evaluation to support management decision-making. This will continue as a major focus in the ANE Bureau.

With regard to financial management concerns, all Asia and Near East Bureau missions are currently in the process of submitting annual updates to a document describing "Mission Financing Policy and Procedures" to the Washington headquarters. These documents are part of a continuing review process which will ensure that all new project proposals submitted for approval include realistic implementation and financing plans.

The Bureau has conducted "vulnerability assessments" of field missions and also has improved audit liaison procedures. This effort has resulted in a reduction of open audit recommendations during the past year.

## CONCLUSION

South Asia has one of the highest, if not the highest, concentrations of poverty in the world. AID has been responding to the challenge of dealing with development there for many years, and will continue to do so. Our budget request for FY 1987 is in line with priorities and emphases in South Asia that we have addressed since the beginning of the Reagan Administration. I appreciate the opportunity to discuss these programs, and look forward to answering your questions.

Mr. OBEY. General.

Lieutenant General GAST. Mr. Chairman, it is a pleasure to testify with my colleagues today. I would like to offer for the record a written statement and a few brief comments.

Mr. Chairman, you recall that last year the Committee encouraged us to improve upon our Congressional Presentation Document (CPD). It felt that we had not been as forthcoming, and the CPD was not as comprehensive as it ought to be, and we did not adequately define the programs. In my testimony before you on the 6th of March I failed to explain to you that we feel we have made significant progress in the CPD. We realize we need to do more to get more program visibility to the Congress.

This document has been worked on very hard between the State Department, Defense, AID, and others to better describe the programs and to justify them and show how the foreign policy and national defense objectives are met by those programs.

Volume I gives a history of the programs and attempts to justify the various parts of them. It categorizes the programs by either cooperative defense and security, deter combat agression, promote regional stability, cash sales, and promote professional military training.

### CHART I CHALLENGES FOR 1986

Now, I used this chart the other day, Mr. Chairman, to review from our perspective as to what challenges are ahead this year. I listed the problem countries, North Korea, Vietnam, Afghanistan, and the difficulties there, which I see as your particular interest in this Committee meeting today, as well as South Yemen, Syria, Libya, Ethiopia, and Angola.

In the CPD color charts here, we have indicated those countries which we see as contributing to the Middle East peace proposal, enhancing cooperative defense, and deterring combat aggression. Within that context, we see Pakistan in the category as a front line state.

In the presentation I also pointed out the various and relative nature of the programs. Pakistan is the only one that shows up on this chart we will be discussing. It is the only one that has military financing as a front line state. It is all Treasury-rate credits for 1987. And that is $340 million this year.

The reason for that request being $15 million more than FY86 is simply the fact that we were unable to deliver on our agreement for '83 at the level that we had asked for. So there is a $15 million markup over last year to compensate for that shortfall in '83, to make the total come out to the $1.6 billion we originally agreed to.

Within the Congressional presentation document, we further explain in volume 1 the objectives for each country. I am only using Pakistan to explain this because it applies for all of them.

There is a significant paragraph in the CPD that talks to the foreign policy and defense relationship and our objectives within the region.

Then we move on to volume 2 of the CPD. Pakistan is on pages 102 and 103. There is actually a breakout of our objectives here and a pie chart that describes the kind of assistance that we intend to provide.

That pie chart reflects our attempt to enhance Pakistan's military competence in the face of the Soviet pressures, and also to indicate that that translates into air defense, radars, fire power, to include artillery, and combat radars, mobility by helicopters, and upgrading tanks on hand. The chart shows new systems as well as upgrading.

Obviously, our concern is to assist Pakistan in our best interest against the Soviet Union and Afghanistan.

The other program discussed in volume I and the latter part of volume II talks to the IMET grant program. That is what I will get into next as it applies to those other countries in South Asis.

So far as India goes, we do not have a foreign military sales program. They buy some things commercially. The buys are not extensive at this time in this case. We have been working hard to have IMET training with a great number of countries because we believe in the longer term it benefits the United States to have a military-to-military relationship.

People come to our country, attend our schools, and see the American values. They meet other people in the region that also attend our schools; we place high value on that. It was not until last year that we were able to work with the Indians to get a reasonably good IMET program. They did not utilize the funds. Last year they began to utilize them very effectively.

This year we are only asking for $400,000 in IMET, but it trains 27 people, including 13 that come here for professional education, management, and some technical training.

For Nepal, we have great interest there because they are promoting expansion of their government and listening more to the public there, we are asking for $125,000. Here we will train some 12 people, three in professional education and management, in an attempt to have that relationship where they are exposed to our values, human rights, and other considerations.

Moving on to Bangladesh, our IMET program is composed of $370,000, under which 50 people will be trained, 19 of them in professional education. Very few people have been trained from this country. And finally in Sri Lanka we are asking for $185,000 to train some 21 people.

We put high value on those training programs. As you know, in many instances these military relationships are not only moderating, but they do result in support for the United States.

Mr. Chairman, that concludes my oral statement.

[Statement follows:]

STATEMENT OF

LIEUTENANT GENERAL PHILIP C. GAST
DIRECTOR, DEFENSE SECURITY ASSISTANCE AGENCY

BEFORE THE

SUBCOMMITTEE ON FOREIGN OPERATIONS
HOUSE APPROPRIATIONS COMMITTEE

IN SUPPORT OF THE

UNITED STATES SECURITY ASSISTANCE PROGRAMS FOR SOUTH ASIA

12 MARCH 1986

## TESTIMONY ON SOUTH ASIA

MR. CHAIRMAN AND MEMBERS OF THE SUBCOMMITTEE:

THANK YOU FOR THE OPPORTUNITY TO APPEAR BEFORE YOU TODAY TO DISCUSS U.S. SECURITY ASSISTANCE PROGRAMS FOR THE SOUTH ASIA REGION. I WOULD LIKE TO ADD SOME BRIEF REMARKS TO SECRETARY PECK'S DETAILED OVERVIEW. I SHALL PROCEED TODAY BY REFERRING YOU TO THE ADMINISTRATION'S NEWLY REDESIGNED CONGRESSIONAL PRESENTATION DOCUMENT. AS YOU KNOW, THE CPD HAS BEEN REVAMPED, IN PART, TO SHOW HOW U.S. PROGRAMS ARE LINKED TO OUR NATIONAL GOALS AND OBJECTIVES. IT PROVIDES A GREAT DEAL OF USEFUL INFORMATION THAT SHOULD BE HELPFUL TO THE SUBCOMMITTEE AS YOU CONSIDER THE ADMINISTRATION'S FY87 BUDGET REQUEST FOR SECURITY ASSISTANCE PROGRAMS. BEFORE TURNING TO THE CPD, I WOULD LIKE TO REFER YOU TO SEVERAL CHARTS THAT HELP PUT THE SOUTH ASIA REGION IN PERSPECTIVE.

### CHART 1: CHALLENGES

I WOULD LIKE TO REMIND THE COMMITTEE OF THE MAJOR CHALLENGES, AS SHOWN ON THIS CHART, THAT WE FACE THROUGHOUT THE WORLD AND ESPECIALLY IN SOUTH ASIA. IT IS AN AREA THAT FACES SIGNIFICANT THREATS BOTH INTERNALLY AND EXTERNALLY. THE SALIENT PROBLEM, FROM OUR PERSPECTIVE, OF COURSE IS THE HEAVY PRESSURE OF SOVIET MILITARY OPERATIONS IN AFGHANISTAN AND ALONG THE BORDERS OF PAKISTAN. WE SHOULD ALSO RECALL, HOWEVER, THE POTENTIAL DANGERS

TO U.S. INTERESTS IN THE REGION CAUSED BY THE TURBULENCE OF THE GULF WAR AND THE SOVIET PRESENCE IN MARXIST SOUTH YEMEN. FROM THE DEFENSE PERSPECTIVE THEN, STRONG RELATIONS WITH THE NATIONS OF SOUTH ASIA, AND PARTICULARLY PAKISTAN, IS A HIGH PRIORITY.

## CHART 2: FMS/MAP FINANCING REQUEST

AS YOU CAN SEE ON THIS CHART (WHICH IS ALSO CONTAINED IN VOLUME I OF THE CPD, PAGE 15) OUR MAJOR PROGRAM IN THIS REGION IS WITH PAKISTAN. FROM A WORLDWIDE PERSPECTIVE, EXTERNAL AGGRESSION AND INTERNAL SUBVERSION REPRESENT FUNDAMENTAL CHALLENGES TO U.S. GLOBAL AND NATIONAL INTERESTS AND TO THE FREEDOM AND SECURITY OF OUR FRIENDS. THE SOVIET UNION AND ITS PROXIES HAVE CONSISTENTLY SUPPLIED MONEY, ARMS AND TRAINING IN EFFORTS TO DESTABILIZE OR OVERTHROW NON-COMMUNIST GOVERNMENTS. OUR SECURITY ASSISTANCE PROGRAMS, THEREFORE, ARE DESIGNED TO SUPPORT OUR FRIENDS AND ALLIES WHO ARE FORCED TO CONFRONT EXTERNALLY SUPPORTED VIOLENCE ON OR WITHIN THEIR BORDERS.

IN RESPONSE TO THE DELIBERATE MILITARY CHALLENGE IN SOUTH ASIA FROM THE SOVIET UNION AND ITS PROXY, AND IN ORDER TO DEPRIVE THEM OF OPPORTUNITIES TO SPREAD TYRANNY IN AREAS ALREADY TROUBLED BY HISTORIC POLITICAL AND ECONOMIC PROBLEMS, THE U.S. USES ITS SECURITY ASSISTANCE PROGRAMS TO SUPPORT FRIENDLY NATIONS WHO CHOOSE TO MAINTAIN OR CREATE TIES TO THE WEST THROUGH THE PROVISION OF MILITARY EQUIPMENT AND TRAINING. UNITED STATES ASSISTANCE NOT ONLY HELPS THREATENED NATIONS DETER EXTERNAL

AGGRESSION, BUT ALSO ENCOURAGES ECONOMIC AND POLITICAL POLICIES MORE CONDUCIVE TO ECONOMIC DEVELOPMENT AND IMPROVED OBSERVATION OF FUNDAMENTAL HUMAN RIGHTS. THE REALITY UNDERLYING THESE PROGRAMS IS THAT THE MORE WE CAN DO TO HELP OTHERS PROTECT THEMSELVES, THE LESS NEED THERE WILL BE FOR DIRECT AMERICAN INVOLVEMENT TO WIN THE PEACE.

## PAKISTAN

IN THE ADMINISTRATION'S REDESIGNED CONGRESSIONAL PRESENTATION DOCUMENT FOR FY87, COUNTRIES ARE GROUPED ACCORDING TO THE PRINCIPAL OBJECTIVES THAT WE SEEK. (THE COMPLETE ALPHABETICAL LIST OF COUNTRIES, BY THE WAY, IS CONTAINED ON PAGES 187-190 OF VOLUME II OF THE CPD.) PAKISTAN IS ONE OF ONLY TEN COUNTRIES FOR WHICH THE PRIMARY REASON FOR THEIR RECEIVING U.S. ASSISTANCE IS TO "DETER AND COMBAT AGGRESSION". PAKISTAN'S HIGH PRIORITY DERIVES FROM ITS DETERMINED STANCE IN THE FACE OF THE DIRECT SOVIET CHALLENGE. PAKISTAN IS OF VITAL IMPORTANCE TO U.S. EFFORTS TO PREVENT FURTHER EXPANSION OF SOVIET INFLUENCE IN SOUTH AND SOUTHWEST ASIA. PAKISTAN CONTINUES ITS OPPOSITION TO THE SOVIET INVASION OF AFGHANISTAN; IT ALSO SEEKS IMPROVED RELATIONS WITH INDIA, THEREBY REDUCING THE POTENTIAL FOR CONFLICT IN SOUTH ASIA. IT ALSO PROVIDES A VOICE OF MODERATION IN ISLAMIC ORGANIZATIONS AND THE NON-ALIGNED MOVEMENT.

WE PLAN EXTENSIVELY AND CAREFULLY WITH PAKISTAN TO FASHION THE MOST COST EFFECTIVE PROGRAM WHICH CONTRIBUTES TO THEIR DEFENSE. I WOULD LIKE TO REFER YOU TO VOLUME II, PAGE 102 OF CPD. AS YOU CAN SEE WE HAVE LISTED IN SHORT FORM OUR POLICY GOALS, WHICH SECRETARY PECK

HAS REVIEWED. I WOULD LIKE TO REFER YOU FURTHER TO OUR PROGRAM OBJECTIVES. FOR THE MILITARY COMPONENT OF THESE OBJECTIVES, WE HAVE USED THE "MISSION AREA" APPROACH WITH THE PAKISTANI MILITARY TO IDENTIFY THEIR HIGHEST PRIORITIES. YOU CAN SEE THAT THEIR MISSIONS ARE DEFENSIVE IN NATURE AND REQUIRE THE CONTINUING MODERNIZATION OF THE ARMED FORCES WITH EMPHASIS ON AIR DEFENSE, FIREPOWER, MOBILITY, ANTI-ARMOR, AND SEA DEFENSE. OUR PROGRAM WILL ALSO ENABLE PAKISTAN TO IMPROVE ITS FORCE READINESS AND THE PROFESSIONALISM OF ITS MILITARY FORCES THROUGH A BROAD RANGE OF OPERATIONAL, TECHNICAL, AND PROFESSIONAL MILITARY TRAINING. ON THE PIE CHART ON THIS PAGE YOU CAN SEE THE RELATIVE PROPORTIONS OF PLANNED MILITARY AND ECONOMIC ASSISTANCE, AND HOW THE MILITARY SLICE OF THE PIE IS FURTHER DIVIDED INTO SYSTEMS UPGRADES, NEW PROCUREMENT, AND COMMAND, CONTROL AND COMMUNICATIONS SYSTEMS PROCUREMENT. AS YOU CAN SEE, THE FMS CREDITS WILL BE USED TO PURCHASE AIRCRAFT, RADARS AND GROUND-TO-AIR MISSILES FOR AIR DEFENSE; ARTILLERY AND COUNTER BATTERY RADARS; AND LIGHT HELICOPTERS FOR MOBILITY. IMPROVEMENTS IN ANTI-ARMOR CAPABILITY ARE ALSO PLANNED THROUGH UPGRADING TANKS ALREADY IN THE PAKISTAN INVENTORY. FINALLY, SEA DEFENSE WILL BE STRENGTHENED BY THE ACQUISITION OF SURVEILLANCE AIRCRAFT AND ANTI-SUBMARINE CAPABILITIES. THIS PLAN WAS DRAWN UP WITH A FULL UNDERSTANDING OF THE FISCAL CONSTRAINTS UNDER WHICH WE MUST OPERATE. IT IS DEFENSIVE IN NATURE; IS ORIENTED TOWARD THE SOVIET THREAT; AND IS THE BASIC MINIMUM TO ENSURE PROGRAM CONTINUITY AND CONTINUED DETERRENCE.

## INDIA

SECRETARY PECK HAS OUTLINED THE IMPORTANCE OF OUR POSITIVELY EVOLVING RELATIONSHIP WITH INDIA. WE ARE NOT REQUESTING FMS CREDITS OR MAP FOR INDIA FOR FY87. CURRENTLY, INDIA PURCHASES U.S. DEFENSE ARTICLES AND SERVICES ON A COMMERCIAL BASIS. IT IS CONSIDERING EXPANDING THESE PURCHASES. AS WITH FUNDED SECURITY ASSISTANCE PROGRAMS, THE EXTENT TO WHICH WE RELEASE TECHNOLOGY FOR COMMERCIAL EXPORTS EVOLVE FROM CONSCIOUS U.S. POLICY DECISIONS, WHICH REFLECT CAREFULLY CONSIDERED BILATERAL EFFORTS TO FURTHER MUTUAL SECURITY AND FOREIGN POLICY OBJECTIVES. (VOLUME II, PAGE 156 OF THE CPD CONTAINS OUR GOALS AND OBJECTIVES FOR INDIA.) ANY PROPOSED SALES TO INDIA WILL BE REVIEWED WITH A VIEW TOWARD PROMOTING STABILITY ON THE SUBCONTINENT. WE ALSO HOPE TO MAINTAIN AND EXPAND MILITARY TO MILITARY RELATIONS TO IMPROVE MUTUAL UNDERSTANDING AND ENHANCE OUR DIALOGUE ON MATTERS OF MUTUAL SECURITY CONCERN.

## IMET

AS EVERYONE IN THIS ROOM IS AWARE, WE CONSIDER THE INTERNATIONAL MILITARY EDUCATION AND TRAINING PROGRAM (IMET) TO BE ONE OF OUR GREATEST SUCCESS STORIES. IMET IS A GRANT AID, RELATIVELY LOW RISK FOREIGN POLICY AND DEFENSE INSTRUMENT THAT SERVES U.S. INTERESTS BY PROVIDING A VALUABLE CHANNEL OF COMMUNICATION AND INFLUENCE WITH FOREIGN COUNTRIES WORLDWIDE.

IN ADDITION TO TRANSMITTING MILITARY SKILLS AND U.S. MILITARY DOCTRINE, IMET CONTRIBUTES TO U.S. POLICY OBJECTIVES BY PROVIDING SIGNIFICANT OPPORTUNITIES FOR ACCESS TO THE CIVILIAN AND MILITARY LEADERSHIP OF OTHER COUNTRIES. THE PROGRAM SUPPORTS U.S. INTERESTS BY CONTINUING TO EXPOSE A SIGNIFICANT SECTOR OF PRESENT AND FUTURE MILITARY LEADERS TO AMERICAN VALUES. THE BEAUTY OF THE TRAINING AVAILABLE THROUGH THIS PROGRAM IS THAT IT SERVES PROFESSIONAL MILITARY PURPOSES. WE INJECT NO POLITICAL INDOCTRINATION, AS THE SOVIET UNION DOES. BUT UNLIKE THE SOVIET SYSTEM, OUR PROGRAM IS OPEN, THAT IS, IT EXPOSES STUDENTS TO AMERICAN CULTURE AND DEMOCRACY IN A NATURAL WAY. THE IMPRESSIONS THESE STUDENTS TAKE HOME ARE OVERWHELMINGLY POSITIVE. WE FIND THAT FORMER IMET STUDENTS RETAIN SYMPATHY, IF NOT AFFECTION, FOR THE U.S., OFTEN EVEN IN CASES WHERE OFFICIALS RELATIONS BETWEEN THE U.S. AND THE STUDENTS' COUNTRY HAVE SUFFERED FOR ONE REASON OR OTHER. THIS PROVIDES A KEY LINK AND HOPE FOR THE FUTURE. FOR COUNTRIES, WITH WHICH WE HAVE CONTINUING STRONG RELATIONS, TIES ARE STRENGTHENED EVEN MORE.

THE PURPOSE OF OUR IMET PROGRAM WITH PAKISTAN IS PRIMARILY TO SUPPORT PAKISTANI TRAINING IN MANAGEMENT, PROFESSIONAL TRAINING AND THE OPERATION OF U.S. MANUFACTURED MILITARY EQUIPMENT. FOR INDIA, THIS PROGRAM WILL HELP CONTINUE TO BUILD RAPPORT BETWEEN THE U.S. AND INDIAN MILITARY ESTABLISHMENTS BY PERMITTING TRAINING AT U.S. SENIOR AND INTERMEDIATE STAFF COLLEGES, AS WELL AS MORE SPECIALIZED TRAINING IN TECHNICAL FIELDS. THE IMET PROGRAM WITH BANGLADESH CONTRIBUTES TO ENHANCED PROFESSIONALISM IN THE BANGLADESH ARMED

FORCES -- A KEY GOVERNING INSTITUTION -- AND SHOULD ENCOURAGE SYMPATHETIC ATTITUDES TOWARD THE U.S. AND DEMOCRATIC VALUES. FOR NEPAL, IMET OFFERS OFFERS PROGESSIONAL TRAINING DESIGNED TO FILL SPECIALIZED TRAINING NEEDS IN COMMUNICATIONS, RANGER, MEDICAL AND OTHER PROGRAMS AND TO IMPROVE NEPAL'S OWN TRAINING PROGRAM. THESE PROGRAMS FACILITATE NEPALESE PARTICIPATION IN INTERNATIONAL PEACE-KEEPING PROGRAMS. IN SRI LANKA, THE IMET PROGRAM WILL INCLUDE TRAINING IN OPERATIONS, LOGISTICS, MAINTENENCE AND COMMUNICATIONS.

IN ALL COUNTRIES IMET TRAINING HELPS CRATE A MORE PROFESSIONAL, EFFICIENT MILITARY. IN ADDITION TO ENHANCING LONG-TERM DEFENSE CAPABILITIES THROUGH BETTER MANAGEMENT, WE HAVE FOUND THAT BETTER-TRAINED, MORE PROFESSIONAL ARMED FORCES ARE MORE HUMANE AND ARE MUCH MORE LIKELY TO SHOW RESPECT FOR HUMAN RIGHTS.

IN CONCLUSION, THERE ARE TWO PRIMARY DOD OBJECTIVES WITHIN THE REGION OF SOUTH ASIA:

-- TO SUPPORT THE SOVEREIGNTY OF THE FRIENDLY REGIONAL STATES AND DENY POLITICAL-MILITARY DOMINATION BY THE SOVIET UNION; AND

-- TO MAINTAIN ACCESS TO PERSIAN GULF OIL.

TO ASSURE THESE INTERESTS, THE U.S., IN CONCERT WITH ALLIES AND FRIENDS, MUST BE PREPARED TO MEET A THREAT OF ANY MAGNITUDE.

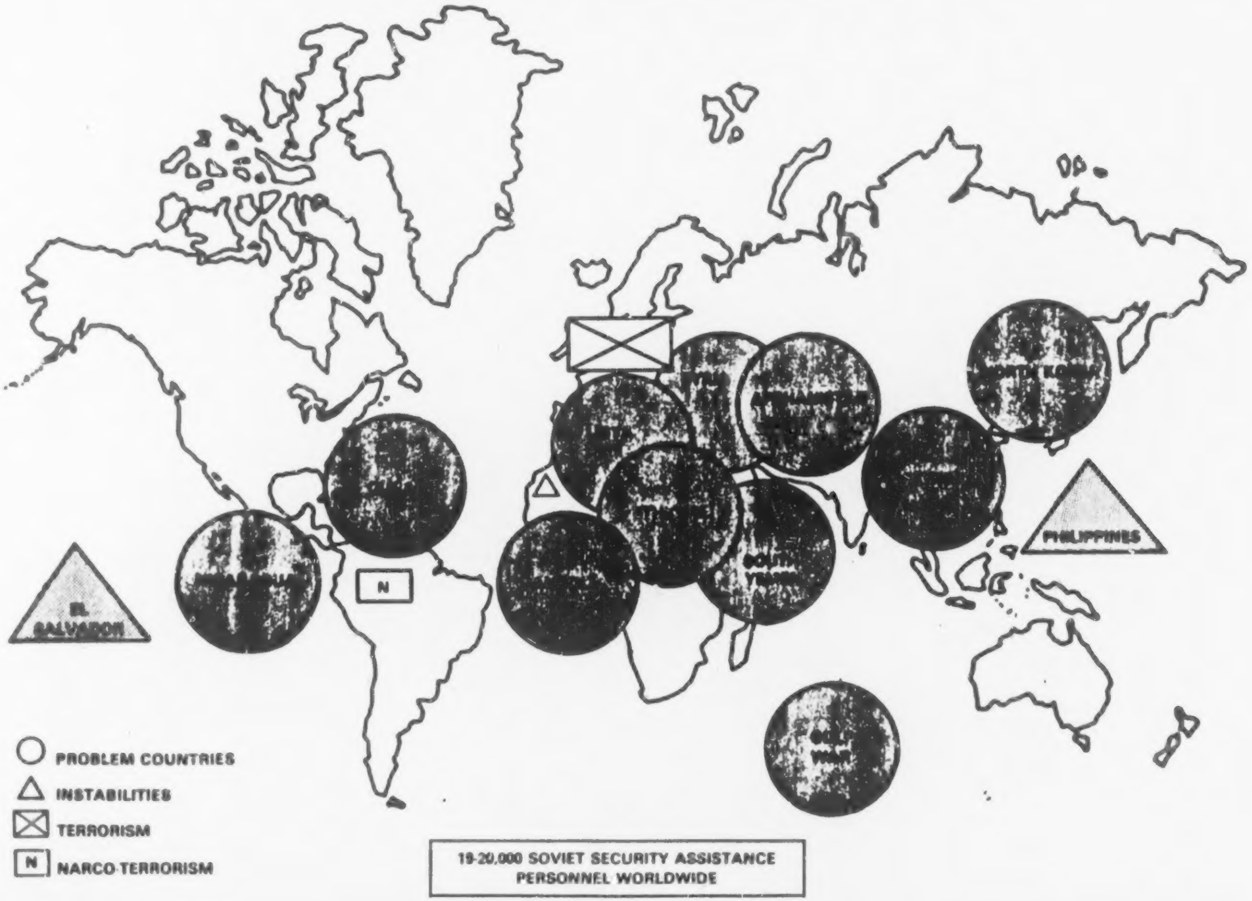
THE FUNDAMENTAL STRATEGIC REQUIREMENT IN THE REGION IS DETERRENCE. TO THIS END, THE MOST BASIC CONTRIBUTION A NATION

CAN MAKE TO U.S. POLICY IS TO BE STABLE AND CAPABLE OF DEFENDING ITSELF. THEREFORE, PROMOTING AND SUPPORTING NATION-BUILDING IS OUR GREATEST CHALLENGE.

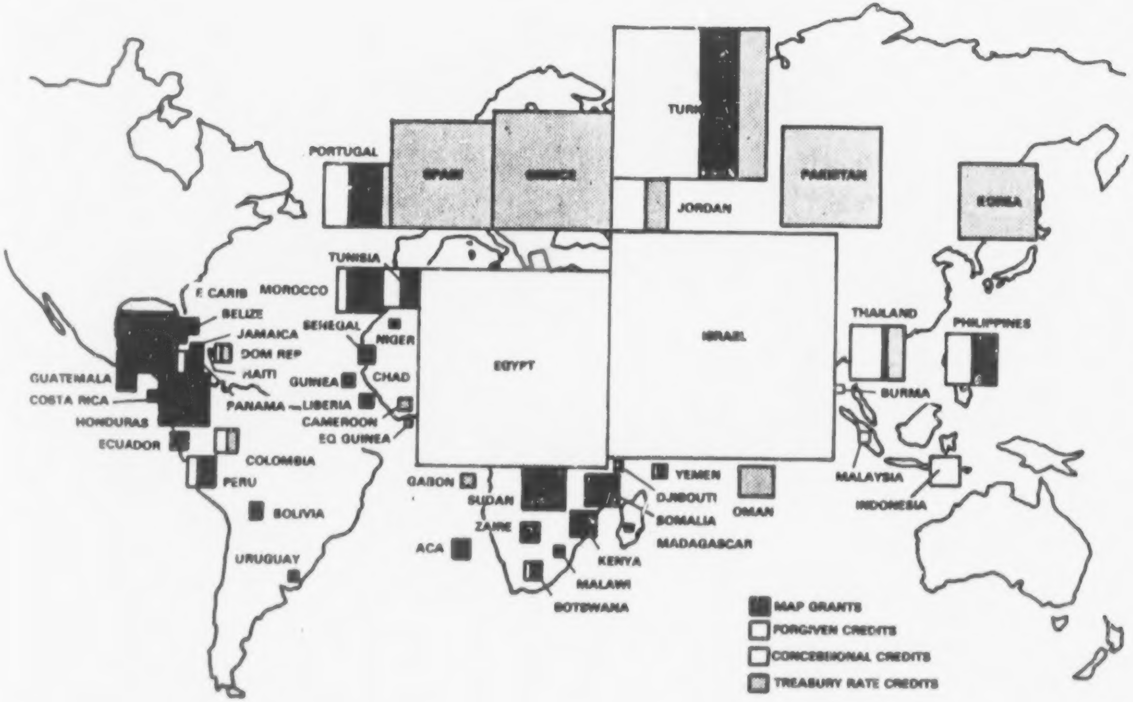
THE MOST IMMEDIATE DANGER IN THE REGION IS DIRECT SOVIET ATTACK ACROSS THE BORDER OF PAKISTAN. SHORT OF CROSS-BORDER ATTACKS, THE SOVIETS WILL CONTINUE TO APPLY PRESSURE ON PAKISTAN TO ACQUIESCE IN ITS OCCUPATION OF AFGHANISTAN. STRONG PAKISTANI ARMED FORCES PROVIDE A DETERRENT TO COERCION AND INTERVENTION BY THE SOVIET UNION.

WE HAVE MADE SIGNIFICANT STRIDES TOWARDS MAINTAINING THE PEACE IN SOUTH ASIA BY HELPING OUR FRIENDS IN THAT REGION. WE CANNOT AFFORD TO TURN OUR BACKS ON THEM NOW AND RUN THE RISK THAT OUR ACCOMPLISHMENTS BE OVERTURNED AND U.S. INTERESTS AND OBJECTIVES THREATENED. THAT CONCLUDES MY REMARKS. I WOULD BE GLAD TO ANSWER ANY OF YOUR QUESTIONS.

# MAJOR CHALLENGES TO THE PEACE


EL SALVADOR
N
PHILIPPINES
○ PROBLEM COUNTRIES
△ INSTABILITIES
☒ TERRORISM
N NARCO-TERRORISM
19-20,000 SOVIET SECURITY ASSISTANCE PERSONNEL WORLDWIDE

## FY 1987 FMS/MAP FINANCING REQUEST
(SCALED TO FINANCING)


PORTUGAL
SPAIN
GREECE
TURK
JORDAN
PAKISTAN
KOREA
TUNISIA
MOROCCO
E CARIB
BELIZE
JAMAICA
DOM REP
HAITI
GUATEMALA
COSTA RICA
HONDURAS
PANAMA
SENEGAL
NIGER
GUINEA
CHAD
LIBERIA
CAMEROON
EQ GUINEA
EGYPT
ISRAEL
THAILAND
BURMA
PHILIPPINES
MALAYSIA
INDONESIA
ECUADOR
COLOMBIA
PERU
BOLIVIA
URUGUAY
GABON
SUDAN
ZAIRE
ACA
YEMEN
DJIBOUTI
SOMALIA
OMAN
MADAGASCAR
KENYA
MALAWI
BOTSWANA
MAP GRANTS
FORGIVEN CREDITS
CONCESSIONAL CREDITS
TREASURY RATE CREDITS

Mr. **Obey**. Thank you.

Gentlemen, I have some tables for the record and a whole series of questions which I want to ask, but I have a time problem which has come up. So I am going to have to cut the hearing fairly short. And I will put the rest of the questions in the record that I do not get to before I leave and ask you to respond to them.

[The tables follow:]

### SOUTH ASIA—1985-87 COMPARISON TABLES (TOTALS)

[Dollars in thousands]

| Country | FY 85 | FY 86 | Proposed FY 87 | FY 86/87 comparison | |
|---|---|---|---|---|---|
| | | | | Amount | Percent |
| Afghanistan | $543 | $16,206 | $15,000 | ($1,206) | (7.4) |
| Bangladesh | 85,406 | 75,263 | 75,370 | 107 | .14 |
| India | 85,282 | 75,311 | 72,310 | (3,001) | (4) |
| Maldives | 22 | 24 | 55 | 31 | 129 |
| Nepal | 21,791 | 16,692 | 16,642 | (50) | (.35) |
| Pakistan | 579,013 | 578,640 | 19,250 | 40,610 | 7 |
| Sri Lanka | 35,266 | 20,916 | 20,938 | 22 | .1 |
| Asia/Near East Region | 0 | 43,926 | 47,400 | 3,474 | 7.9 |
| Total | 807,323 | 826,978 | 866,965 | 39,987 | 4.8 |

### SOUTH ASIA—DEVELOPMENT ASSISTANCE

[Dollars in thousands]

| Country | FY 85 | FY 86 | Proposed FY 87 | FY 86/87 comparison | |
|---|---|---|---|---|---|
| | | | | Amount | Percent |
| Afghanistan | 0 | 0 | 0 | 0 | |
| Bangladash | $85,070 | $75,000 | $75,000 | 0 | |
| India | 85,070 | 75,000 | 72,000 | ($3,000) | (4) |
| Maldives | 22 | 24 | 55 | 31 | 129 |
| Nepal | 125 | 96 | 125 | 41 | 28.5 |
| Pakistan | 970 | 885 | 1,440 | 555 | 63 |
| Sri Lanka | 148 | 144 | 185 | 41 | 28.5 |
| Total | 1,883 | 1,723 | 2,575 | 852 | 49 |

### SOUTH ASIA—ECONOMIC SUPPORT FUND

[Dollars in thousands]

| Country | FY 85 | FY 86 | Proposed FY 87 | FY 86/87 comparison | |
|---|---|---|---|---|---|
| | | | | Amount | Percent |
| Afghanistan | $543 | $16,206 | $15,000 | ($1,206) | (7.5) |
| Bangladesh | 0 | 0 | 0 | | |
| India | 0 | 0 | 0 | | |
| Maldives | 0 | 0 | 0 | | |
| Nepal | 0 | 0 | 0 | | |
| Pakistan | 200,000 | 239,250 | 250,000 | 10,750 | 4.5 |
| Sri Lanka | 0 | 0 | 0 | | |
| Asia/Near East Region | 0 | 17,779 | 25,000 | 7,221 | 40 |
| Total | 200,543 | 273,235 | 290,000 | 16,765 | 6 |

## SOUTH ASIA—PEACE CORPS

[Dollars in thousands]

| Country | FY 85 | FY 86 | Proposed FY 87 | FY 86/87 comparison | |
|---|---|---|---|---|---|
| | | | | Amount | Percent |
| Bangladesh | 0 | 0 | 0 | 0 | |
| India | 0 | 0 | 0 | 0 | |
| Maldives | 0 | 0 | 0 | 0 | |
| Nepal | $2,538 | $2,196 | $2,117 | ($79) | (3.5) |
| Pakistan | 0 | 0 | 0 | 0 | |
| Sri Lanka | 456 | 772 | 753 | (19) | (2.5) |
| Total | 2,994 | 2,968 | 2,870 | (98) | (3) |

## SOUTH ASIA—ANTI NARCOTICS ASSISTANCE

[Dollars in thousands]

| Country | FY 85 | FY 86 | Proposed FY 87 | FY 86/87 comparison | |
|---|---|---|---|---|---|
| | | | | Amount | Percent |
| Pakistan | $3,043 | $3,480 | $2,850 | ($630) | (18) |
| Asia/Near East Region | 0 | 365 | 300 | (65) | (18) |
| Total | 3,043 | 3,845 | 3,150 | (695) | (18) |

## SOUTH ASIA—FOREIGN MILITARY SALES*

[Dollars in thousands]

| Country | FY 85 | FY 86 | Proposed FY 87 | FY 86/87 comparison | |
|---|---|---|---|---|---|
| | | | | Amount | Percent |
| Pakistan | $325,000 | $311,025 | $340,000 | $28,975 | 9 |

*No MAP for So. Asia

## SOUTH ASIA—INT'L MILITARY, EDUCATION AND TRAINING

[Dollars in thousands]

| Country | FY 85 | FY 86 | Proposed FY 87 | FY 86/87 comparison | |
|---|---|---|---|---|---|
| | | | | Amount | Percent |
| Bangladesh | 336 | $263 | $370 | $107 | 41 |
| India | 282 | 311 | 400 | 89 | 28.5 |
| Maldives | 22 | 24 | 55 | 31 | 129 |
| Nepal | 125 | 96 | 125 | 29 | 30 |
| Pakistan | 970 | 885 | 1,440 | 555 | 63 |
| Sri Lanka | 148 | 144 | 185 | 41 | 29.5 |
| Total | 1,883 | 1,723 | 2,575 | 852 | 49 |

### EXPROPRIATION OF U.S. INVESTMENTS IN SRI LANKA

Mr. OBEY. Before I begin my questioning, let me simply say that I have been requested by Mr. Lehman to raise one question with you regarding Sri Lanka. And it is expropriation of U.S. investments.

And he indicates that he has become aware of a problem that some small U.S. companies have encountered with the Government of Sri Lanka. He indicates that his information is that the Sri Lanka government has apparently reneged on its obligations to protect U.S. development investment. Two companies in particular have come to his attention, one of which attempted but did not receive any resolution through the Sri Lankan courts.

Then he asked this: Could you please tell us how intensive the problem of expropriation is of large and small U.S. investments by the Sri Lanka government and what kind of steps you are taking to achieve the favorable resolution for these companies.

It is his understanding that the interagency group on expropriation has not vigorously pursued such a resolution.

Mr. RAPHEL. Mr. Chairman, I am not aware that this is an issue. But we will certainly follow up right away and get back to you on it.

[The information follows:]

## CONGRESSIONAL RESPONSE ON SRI LANKA

*Question.* I recently became aware of a problem that some small U.S. companies have encountered with the Government of Sri Lanka. The Sri Lankan Government has apparently reneged on its obligations to protect U.S. private development investments. Two companies in particular have come to my attention, one of which attempted but did not receive any resolution through the Sri Lankan courts. Can you please tell me how extensive the problem of expropriation is of large and small U.S. business investments by the Sri Lankan government, and also what kind of steps you are taking to achieve a favorable resolution for these companies. I understand that the Interagency Group on Expropriation has not vigorously pursued such a resolution.

Answer. We believe the two companies you referred to are Charlanka and Lankamerica.

### CHARLANKA

In September 1981, Enterprise Development Corporation Inc. (EDI), owned by a U.S. citizen, attempted to organize a joint venture, "Charlanka", with the Sri Lankan Government's State Timber Corporation (STC) to manufacture charcoal.

In 1982, prior to the operational establishment of Charlanka, STC and EDI became involved in a dispute concerning whether STC could gain controlling interest of the venture by buying Charlanka stock on behalf of STC employees. The parties have held extensive discussions, but the case is at an impasse. EDI has declined to pursue its case through the Sri Lankan court system, and has rejected a Sri Lankan proposal for a fact-finding procedure. The Sri Lankan Government has rejected an EDI proposal for third party arbitration.

The State Department has been involved in the case since 1988, when Mr. Steve Keiley, President of EDI, approached the Embassy in Colombo requesting assistance in resolving the dispute. The Embassy has used its good offices to bring the disputing parties together; and Embassy officers, including the Ambassador, have made a number of demarches to the Sri Lankan Government to resolve the dispute. In November 1985, the Interagency Expropriation Group ("Expro Group") considered the Charlanka case at Mr. Keiley's request, to determine whether an expropriation had occurred and recommend appropriate U.S. Government action. The Expro Group was unable to reach a conclusion concerning expropriation based on the evidence submitted by EDI. Consequently, two State Department officers met with Mr. Keiley and his attorney to review other documentation which EDI believes supports its position. The Expro Group planned to consider these additional submissions at a meeting during March. In view of uncertainty concerning the facts, the Expro Group also decided that the U.S. Government should continue to use its good offices in order to formulate a fact-finding procedure acceptable to both sides.

On February 26, Mr. Keiley requested that Charlanka be dropped from the March meeting agenda. The Expro Group will consider the case further when Keiley requests.

### LANKAMERICA

Our records indicate that Lankamerica's owners have been in touch with the Embassy in Colombo which has been assisting them. According to a letter dated January 16, 1986, Lankamerica is pursuing its case through the Sri Lankan court system. While the findings thus far have not been to Lankamerica's satisfaction, local legal remedies still remain open. The case has not been raised before the Expro Group.

### EXPROPRIATION OF U.S. FIRMS IN SRI LANKA

Sri Lanka treatment of foreign investors has improved substantially since 1977, a year which marked a significant turning point in that country's economic development strategy. Prior to that date, a series of governments pursued policies strongly oriented towards social welfare and state control of the economy. This lead to widespread nationalization of foreign assets and businesses, including the 1963 expropriation of Esso and Mobil service stations, resulting in our first invocation of the Hickenlooper Amendment. These expropriation cases were later resolved and sanctions were lifted. Subsequent to the election of the current Government in 1977, Sri Lanka realized the importance of private enterprise and foreign investment in promoting economic development. Appropriate economic policies were put in place to meet these ends and they have been generally maintained to present. With the exception of Charlanka, there have been no allegations of expropriations of U.S. investments in Sri Lanka since 1977. All previously outstanding expropriations involving U.S. interests have been settled to the satisfaction of the investors.

### SOVIET ACTION IN AFGHANISTAN

Mr. OBEY. Okay. Let me give Mr. Lewis a minute to get organized. But let me ask you a few questions on the Afghanistan situation, and I will return to that later in the questions.

Like you I am appalled at the Soviet actions in Afghanistan. I think it is indicative both simultaneously of arrogance and paranoia. I would like to think that our aid and I would like to think that the activities of the Afghan rebel would lead to a constructive resolution of that situation. Frankly I am not at all optimistic that it will.

Let me just ask you a couple of questions. What is our evaluation? What is our best consensus evaluation of the ability of the Afghans to inflict sufficient pain on Soviet invasion and occupation forces to lead them to either withdraw, reform, negotiate, you name it?

Mr. RAPHEL. We both felt that is the only way the Soviets are going to be convinced that it is smarter for them to negotiate a withdrawal that will not threaten their own national interest rather than to stay on and continue to fight.

There has to be intense pressure on the Soviets in two specific areas. The first one is diplomatic. People often note, and they are absolutely right, that the Soviet Union has not shown much sensitivity in the past to public opinion and statements against them. But in the Islamic Conference meeting it hurts them. In the Islamic world, they pay the price. That is why we are going ahead with a major diplomatic initiative, keeping pressure on the Soviets.

That is why we think it is so important that the alliance be able to be portrayed internationally as not only a viable fighting force, which it is, but one that is more unified, speaking with one voice internationally.

The second parallel channel that has to be followed is military pressure inside Afghanistan on the Soviet Union. We think the resistance is doing very well indeed when you take into account that the Soviets have been in Afghanistan now for more than six years, have 120,000 troops inside Afghanistan, have 30,000 right across the border in the Soviet Union, and have one of the most modern, technologically advanced armies in the world. They use the most heinous and reprehensible means of warfare, including butterfly mines to maim small children.

In the face of that, you have a fairly small group of lightly armed resistance fighters that in effect fought the Soviets to a standstill. They control no more territory than they did in 1980 and control no more population than they did in 1980. It is a testament to the Afghan people.

As long as we keep intense pressure on both of these fronts, we believe that the Soviets—it is going to take time, take a lot of pressure—will come to the point where they think those negotiations in Geneva are a better way to fight than to back out.

Mr. OBEY. Let me ask a more philosophical question. You know what the argument is that is made by some people. They say, look, it is a valiant effort, worthy cause, but as a practical matter the Soviets are not going to get out. And therefore they raise the question of whether on a personal, human, and moral level, whether it is right for us to encourage the continuation of their struggle.

And what they will ask is, look, are you sure we are not just using these people as cannon fodder in a slow grinding effort which will not gain much ground for them, which will wear the Soviets to some extent but really just serves as a nuisance value in terms of cutting up the Soviets in the Islamic world without really offering the individuals involved a lot of hope?

I do not want to think that the implications of that question are correct. And this Committee has been I think very forthcoming in terms of its aid both to Pakistan and to the Afghans. But I have to say that the questions and implications bother me and bother me a lot on the human level. And I would like to hear your response to that.

Mr. RAPHEL. It is a very good question.

Mr. OBEY. In your response I would like to know whether we have any estimate at all of what do we think the possibilities are if you had to make book on them, that some time this year, next year, the following year, or the year after that, any time in the next four years the Soviets in fact would wind up acceptably negotiating this issue?

Mr. RAPHEL. It is a very good question, Mr. Chairman. You are right in looking at the carryings on in Afghanistan. We are told that the Afghans are refugees either in their own country or across the border. It cannot help but give you pause.

But I also find the question a false question, in some fundamental ways. First, it is not the United States encouraging the Afghan people to fight for their freedom; it is the Afghan people choosing to fight for freedom and fight for independence from Soviet occupation. They have asked for help. And they do receive help in various kinds of ways and from various people. And in my view it is help well deserved.

I would turn the question around and say if there are any people in the world who are fighting for independence and freedom, and if there is any national liberation struggle in the world—I realize it is a buzz word—it is in Afghanistan.

And if people who engage in that kind of struggle turn to the United States, and with our traditions and feeling for Afghan people and feelings for liberty, to me it is inconceivable that we turn our backs. And it is in the best tradition not to turn our backs in that kind of situation.

Mr. OBEY. I agree with that. I agree with you that especially because this is a clear instance of cross border messing around that the Soviets have no blasted business engaging in. From that standpoint we are clearly on the high, moral ground.

What I do wonder, however, is what our own assessments are about whether our hopes and our desires, whether we have any expectation that those hopes and desires would go beyond the point of simply embarrassing the Soviets, which in and of itself is useful, I do not mind that. But there are people getting killed that we care about.

## POSSIBILITY OF RESOLUTION

And my question is: what do we think the likelihood is that any time in the remainder of the eighties let us say that we are going to see any other resolution of this situation?

Mr. RAPHEL. It is obviously really tough to predict. My father once told me never bet on NCAA tournaments or what the Soviets are going to do. And he was right in both cases.

There has been some interesting signals from the Soviets. The question is, is there any substance behind them? A couple of things have happened over the last year. First, the major one is the change in leadership in the Soviet Union.

A number of commentators—Soviet experts—look at that and say it might be that with the new leadership they might be more interested in finding a way out with honor of that situation as Gorbachev finds himself less tied to the past policy. Second, there have been interesting signals in the media for the Soviets over the past four or five months saying, yes, they really want to find a negotiated way out.

Of course, the basic question is that really tactics, propaganda, or is there real interest in finding a way out of Afghanistan? So far, to be candid, we have not seen anything in terms of Geneva negotiations, for example, that would show that they have made a fundamental decision they really want to get out.

Third, in terms of both the conversation that the President had with Gorbachev and the conversations at the Geneva negotiations, once again the Soviets verbally have been more forthcoming than they have in the past. I have not yet seen that translated to sactions.

Finally, the reason we think that this strategy can succeed—I do not want to sound like Pollyanna, but I believe we can succeed. What we are asking is for an Afghanistan like the Afghanistan that used to exist. We are not asking for an American puppet government. We are asking for a government that has the spirit of the Afghan people, one that is not aligned, one that does not pose a threat to the Soviet Union.

And I would contend that if the Soviets can find a way that can make the process of getting out one without losing face, the idea of having a government there that is not a threat to the Soviet Union in terms of direct security threat, one that is not aligned, is not harmful to Soviet interests.

And I think there is an answer out there. But to be frank, it is going to be a tough row to hoe. But we think we are going in the right direction.

Mr. OBEY. I hope you are right. When we had two occasions on which Members of Congress met with Soviets, once in Moscow and once here, discussing the regional differences, obviously one of the issues we raised was Afghanistan. And I wish I could say that I felt that there was any indication from those conversations——

Mr. WILSON. Will the Chairman yield on that point?

Mr. OBEY. I will after I make my point.

I wish I could feel that the Soviets have given any indication that they were seriously considering that. But my reading of them is that they are not likely to.

Go ahead.

Mr. WILSON. I think the Chairman has raised a question of a moral question that is raised occasionally. I would ask the Secretary if he shares my view, and that is that the borrow struggle argument is pretty much neutralized by the fact that—or do you agree—that the Afghans are the type people, they would fight to death with pitchforks.

So what we are really doing by helping them in my judgment is we are not allowing men to sell their lives. But as far as the death of the Afghans, that is a certainty. They would die within Enfield 303s and pitchforks without inflicting casualties with the pitchforks.

### COST TO SOVIETS

Mr. OBEY. This is where I am leading in these questions. What I would be interested in knowing is—let me just spit them out all at once so you can respond to them all at once. I would like to know what our estimate is of what this is costing the Soviets, not just in terms of lives and equipment, but what is it costing them economically in terms of devotion of resources.

Is it having any appreciable drain on them militarily, economically? What are other people besides the United States doing to assist the Afghans? Have we asked any of our allies to do anything to assist which they have not done?

In other words, if we are engaged in this kind of effort and if it is going to be as protracted as it appears to me to be, and if we are participating in the process of continuing that struggle, what are we doing to maximize the opportunity to bring it to a decent resolution?

Mr. RAPHEL. A couple of points, Mr. Chairman.

First, I want to reaffirm what Mr. Wilson just said, that as I mentioned in responding to your original question, it is really not a question of us encouraging on the Afghans. They are embarked on a course that will continue the struggle. And it is really an issue of whether we are going to help or are we not.

In terms of cost to the Soviets, it is evident to us that the Soviets want to continue this at the level they are doing it now. It is not causing great hardship to the Soviet Union in terms of the numbers of casualties even though we estimate there are probably up to 50,000 casualties since the war started. The Soviets are not as sensitive to that as the American people.

In terms of the number of years there, the drain on Soviet military equipment, it is a burden that they can carry. They have made the policy decision that it is in their interest to still carry the burden. The crucial question is whether or not they will continue to come down on the same side of the policy that on balance it is worth doing.

Second, from what others are doing to assist Afghanistan, there is a related question of assisting Pakistan because Pakistan is carrying the major burden in this confrontation. For example, from the beginning of this struggle, the UNHCR has spent an estimated $2.1 billion to assist refugees in Pakistan. Ourselves, the Europeans, and others have extensive PVO programs. The Europeans have economic and security assistance programs in Pakistan, not the size of ours, but nevertheless significant. The Japanese help.

### ALLIES COOPERATION

So I think our friends around the world have weighed in both on the economic side and security assistance side.

Mr. **Obey**. Are you satisfied with their degree of effort and participation?

Mr. **Raphel**. We would always like more help.

Mr. **Obey**. I go back to my last question: are there any specific things that we have asked allies to do which would increase the pressure on the Soviets that they have not done?

Mr. **Raphel**. I am not aware of going to allies and asking for cooperation on this issue where it has not been provided.

Mr. **Obey**. Mr. Lewis.

Mr. **Lewis**. Thank you, Mr. Chairman.

### PAKISTAN PROGRAM

Same region, a little different slant. Pakistan is a country that is a very important ally and friend, strategically located. Presently we are paying a good deal of attention to the role that Pakistan has played regard afganistan play vis-a-vis the questions the Chairman is addressing. That has led to a pretty sizable request for an increase in Pakistan's budget.

I would ask you to respond to two sides of this question. On the one hand the Chairman has appropriately outlined the problem we have with the budget, domestic as well as these foreign assistance programs.

Can we justify those kinds of increases in view of the pressure here at home? As we got economic problems here at home, so does Pakistan. I would be very interested in your analysis of any pattern which indicated that Pakistan may be using that extra funding for purposes that would concern us. Specifically I would mention the long running history of trouble between the Indian-Pakistan border.

Mr. RAPHEL. Increase of the program, you are talking about the follow-on program or specifically for FY-87?

Mr. LEWIS. Start with FY-87.

Mr. RAPHEL. I will make one general statement. There really has not been a major increase in the program. '87 is the last year of the multi-year commitment with Pakistan. In '87 the program increased slightly in order to make up shortfalls from previous years.

I will refer to General Gast for comment on the military side of the program.

Lieutenant General GAST. Mr. Lewis, I covered earlier that the reason for going from 325 million to 340 million this particular year as contrasted to last year was because in '83 we were only able to provide some 300, which is 15 million short of the agreed to figure when we began the current six-year program.

Over the period, somewhat due to our embargo and when relationships were not as good, the Pakistan armed forces suffered a great deal of deterioration in terms of obsolescence. Neither their Army or their Air Force or air defense or Navy—because they have to consider a naval threat—were modernized. Yet the Soviets are bringing pressure in the north and perhaps in the south. They have been able to modernize, but not to much extent at all, although they have received some assistance, as you know, from the PRC and others.

Our working with them over these last two or three years that I have been involved with them has made it very strikingly clear, made it very stark, that in fact that deterioration continues and is only gradually being offset by the sales of some 40 F16s and some modernization of old tanks, a little bit in their Navy, some in artillery, and some in air defense.

We believe that if they are able to be able to militarily deter growing encroachments by the Soviets in the future, to give the military the resolve they need as well as to reassure the civilian people, that there is a need to somehow or other to modernize their armed forces.

Our weapon systems are very expensive, as you know. And it is a fact, as you know from other committees, that what we are able to provide at 320 million a year, or 300, depending on the future programs, is not a lot in hardware, nor does it contribute in my view or our view to an arms race. These numbers and the kind of things that we are willing to provide are not a threat to India in our view. They are oriented toward withstanding the threat and preserving deterrence in regard to Afghanistan.

## INDIA'S REACTION TO U.S. AID TO PAKISTAN

Mr. LEWIS. With the change, shift of government in India, Prime Minister Gandhi taking a little different approach have we received expressions of concern on their part relative to the military assistance we are giving, to Pakistan, and what are they asking?

Lieutenant General GAST. I will ask Mr. Raphel to respond to that. He is more in touch with that.

I would only add that the sort of things we are providing to them and the capabilities we have we believe are defensive in nature.

Mr. RAPHEL. The Government of India has expressed concern. They obviously worry about how all the equipment is going to be used. As you know, this has been a traditional concern on the subcontinent in view of history.

Conversely, we found the Pakistanis welcome Prime Minister Rajiv's coming in power. And since the advent of the democratic government in Pakistan, there had been reconciliation on the subcontinent. By our account the leaders met six times during the past year to talk about reconciliation and accommodation in South Asia and have taken a number of public steps to move closer.

Mr. LEWIS. Six times?

Mr. RAPHEL. Six times to move closer to accommodation. We see a very positive trend in South Asia. Although we might disagree with India over the issue of Pakistan, it has not stood in the way of a major improvement of U.S.-India relations.

### HUMAN RIGHTS IN PAKISTAN

Mr. LEWIS. You opened the door to the next area of questioning I was interested in. President Zia has taken limited steps towards representative government including an elected national assembly, et cetera. There are a lot of questions that remain relative to human rights, problems in his country. To what extent have we encouraged President Zia to undertake human rights and democratic reforms?

Mr. RAPHEL. Mr. Constantine has talked to President Zia and the government of Pakistan. We think one of the reasons they were able to take the step to move to a democratic government was because of the confidence they have in their relationship with us. We have informally heard from some Pakistani friends about the fact that the start of their civilian government went unnoted in the rest of the world. Maybe the problem is it happened peacefully. There were no people in the streets.

There is a democratically elected government, there is a cabinet and Prime Minister who is very active in all areas of the decision making in Pakistan. The government of Pakistan tells us now there are no political prisoners in Pakistan. The martial law courts have been abolished. And it really is in our view a much more effective and functioning form of government in terms of its last democratic form of government.

The irony as, we know, is that sometimes it is a little tougher than working with another kind of agreement in getting decisions made and in responsiveness. But nevertheless, it is a price we gladly pay. I think the change has been underrated. Pakistan really did take a major step at the beginning of the year.

### EFFECTS OF U.S. ASSISTANCE ON PAKISTAN

Mr. LEWIS. As we were talking earlier today about the Philippines a lot and discussing the new hopes for expanded democracy, we also discussed the possible need for conditions on our expanded assistance. The past implicit conditions, attitudes, pressure of the United States and our relationship in an economic aid sense, what impact did that have upon some of these changes? Did we play a role in that? Did we affect that change?

Mr. **Raphel**. We like to think that our approaches were effective. We never went to Pakistan and said either you will do the following eight things or we cut you off. Because we do not think that is effective. We have made our wants known.

You have seen the abolition of martial law, significant steps taken on narcotics, and steps taken on economic reform. Pakistan's growth rate last year was over 6 percent. You have seen Pakistan remain constant and firm on the issue of Afghanistan.

So you go over the score card in the last five years since we have had this program, you see what we have encouraged and what has happened. And I think we are really looking fairly good.

Mr. **Lewis**. Thank you, Mr. Chairman.

Mr. **Obey**. Mr. Wilson.

### RELATIONSHIP BETWEEN INDIA AND PAKISTAN

Mr. **Wilson**. Thank you, Mr. Chairman.

You will have to cut me off, Mr. Chairman, because I am sure I have got more questions than we have got time.

I would just like to make an observation to what Mr. Gast said. Jerry, I know you are interested in this but, you know, talking about Pakistan being a threat to India is like talking about Canada being a threat to the United States. India has got ten times the population, six times the Army. They make T-72s in New Dehli. India is an extremely well armed country and ten times the size of Pakistan.

Mr. **Lewis**. If the gentleman will yield, my staffer just said to me, "you know, you are a lot more supportive of Pakistan than you seem in these hearings." And my response was that is because we have got Charlie Wilson here.

Mr. **Wilson**. Nevertheless, India is ten times the size of Pakistan, much larger Army, Navy. And in general Pakistan is not modernizing tanks, they are buying new tanks. They have yet to modernize the first T-59.

Lieutenant General **Gast**. I only meant the M-45 program, sir.

Mr. **Wilson**. Right. Mr. Raphel, I do not quite know what the pecking order is in the State Department——

Mr. **Raphel**. I wonder about it sometimes.

Mr. **Wilson**. Where are you?

Mr. **Raphel**. My mother used to ask me that. In the Near East and South Asian Bureau I am Dick Murphy's Deputy Assistant Secretary. We have five Deputy Assistant Secretaries. And the other guys worry about other regions. Bob Peck has the flu today.

Mr. **Wilson**. Is he a subordinate to you?

Mr. **Raphel**. Sort of equal, I am the Principal Deputy. And then there are four other Deputy Assistant Secretaries.

### HUMANITARIAN AID TO AFGHANISTAN

Mr. **Wilson**. Well, I would like to say that I understand that the State Department's own position now is to hold up or block less than $2 million of the money that we have made available for humanitarian aid for the Afghans, especially across the border aid, I certainly hope that that remains as much as you can through Ambassador Helman's holdup of Congress and the White House's intentions.

I would also like to complement Mr. Greenleaf on the extremely good job that is being done on the northwest frontier by AID. Crandall and the other guys out there are just absolutely super. And it is marvelous work.

I think the only refugees in the world, Mr. Chairman, that are better cared for than the Afghan refugees are probably the refugees displaced on Cyprus that live better than my constituents do. But as far as medical care and all the other things provided to the enormous number, 3 million Afghan refugees, I just think that our various relief activities have been good, United Way has been good, everybody else has been good.

I am distressed that the State Department is so unable to carry out the President's wishes and Congressional wishes. And I would say to my liberal friends who really oppose the contra aid, on a humanitarian basis forget it, do not worry about it because the State Department is administering it and it is not going to get there. And you do not need to carry some sort of moral outrage about it.

They will not get it, they will not get it. And if they do, they will put Ambassador Helman in charge of it. And they damn sure will not get it.

There are four wars going on right now that the United States has some interest in, some people in the United States have some interest in assisting the insurgents, this one, Angola, Cambodia, and Nicaragua. This one I think most of us agree is less controversial than any of the others. You do not hear much argument about this one except the point that the Chairman made which is very important.

And if I thought for a minute that the policy of the United States—and I think it would be the policy of some people in the State Department, but that the policy in the United States was simply to keep these guys in the field and simply to continue to harass the Soviets but not give them a chance to win, if I thought for a minute that that was the policy of the President of the United States or of this Administration, then my support for the Afghan effort immediately would go away.

And I hope the Chairman is able to get out there and meet with some of the people on the northwest frontier. But I just want to underline that my experience in my six visits is that as you said we do not have to help them. We do not have to encourage them.

It is just a matter of how cheaply they are going to sell their lives. It really amounts to that. It amounts to whether or not as the great bastion of freedom in the world we are going to let them sell their lives extremely cheaply or are we going to make it expensive for the Soviet Union. That is really what it gets down to.

They are going to fight. They have been doing it for thousands of years. They are not going to give up. They are going to have rifles, they are going to have rocks, and they are not going to allow their country to be overrun by the heathens from the north or from the south or anywhere else without one hell of a fight. And there will not be anybody left.

## HUMAN RIGHTS IN AFGHANISTAN

I know the Chairman is very interested in this, and I believe the Chairman intends to hold meetings concerning human rights violations in Afghanistan at a later time, but would any of you like to address yourself a little more to the sorts of things that the Soviets are doing as far as trying to deny medical care, as far as trying to create epidemics, as far as carpet bombing, and trying to actually kill the civilian population.

Mr. **Raphel**. What I find extraordinary is the UN appointed someone to tour Afghanistan on human rights. And he published his report last year. Keep in mind this comes from the UN. It is an extraordinary condemnation and indictment of Soviet practice in Afghanistan.

Mr. **Wilson**. That report was endorsed by everybody except the Iron Curtain countries, Cuba, and India I believe?

Mr. **Raphel**. That is right. Reading it, you would almost like to make it compulsory reading for Americans. Because when you read the specific examples in that report of the type of thing——

Mr. **Wilson**. Could you give the Committee examples?

Mr. **Raphel**. One of them of course has been talked about a lot, but is one of the most outrageous, is strewing mines in the shape of toys. And children pick them up and have their hands blown up. I am sure you have seen hospitals on the Pak side of the border, you can see children without arms, without legs as a result of this.

The Soviets have used napalm carpet bombs. At least in '82, the Soviets were using chemical warfare in Afghanistan. There are cases of elderly men refusing to leave villages and then having dynamite tied around them; throwing children in wells, throwing dynamite in wells. It is the most outrageous practice, violation of all human norms, attested to by the United Nations. It is regrettable it does not get more attention on the world scene.

And we want to get more media attention as to what is going on inside the Afghanistan. If more people knew about it, there would be much more sense of outrage than there is now.

Mr. **Wilson**. That is all, Mr. Chairman.

Mr. **Obey**. Are you sure?

Mr. **Wilson**. Yes.

Mr. **Greenleaf**. Mr. Chairman, may I just make a brief comment? I appreciate the Congressman's remarks about AID's efforts.

Mr. **Wilson**. I hate to interrupt here, but I will. You are having to do things innovatively and differently than you have done them in the past. You are having to think. And that is what your guys are doing out there. And I compliment you out there.

Mr. **Greenleaf**. Thank you very much. And things do not go as far as we would like them to go nor do they go as quickly as your colleagues on the Committee would like. But I think it is fair to say with respect to the so-called short-term money that you have been particularly interested in, we are now up to the point where over $7 million of the $8 million is obligated. We are really in the final stages.

This involves complicated negotiations with PVOs here as well as PVOs overseas, and you are of course intimately familiar with this.

With your prodding, that short-term emergency program that the Congress first funded is moving to its completion.

### PAKISTAN'S MOVEMENT TOWARD DEMOCRACY

We are now really focusing primarily on the larger and longer term program that was funded in the current budget, which we are still working out with the resistance Alliance that Mr. Raphel alluded to at the outset. We are also working out the administrative arrangements with the government of Pakistan.

I should also add that really this is a tri-partician effort. Because the Department of Defense is very much involved in this through the $10 million McCollum Amendment, amendment to the DOD authorization.

Mr. **Wilson**. I would like to make a point there for the Chairman's benefit, that proof of Pakistani movement toward democracy is the reduced efficiency of their government. Mr. McCollum had an amendment to provide that an airplane should fly from here to Pakistan to deliver medical supplies, partially which were furnished by this Committee through funding and partially which were gathered voluntarily. And I saw great frustration with the Presidency in trying to get the various bureaucratic red tape cut for that airplane to land, because it was a big problem. It would not have existed before the democracy began to function.

Mr. **Greenleaf**. But the first flight has taken place as of last week.

Mr. **Wilson**. For the record, I do not know who would be the right one to do it, but I think the Committee would appreciate, because we have so many different efforts going on, the Committee would probably appreciate a little summary of the various programs and efforts that are going on by the U.S. Government.

Mr. **Obey**. Let me talk about the question raised by Mr. Lewis. I am certainly aware of the fact that the Pakistanis are interested in an increased aid package. What I am wondering is what you are telling them in terms of the realism of that expectation or hope.

What I have tried to explain to them in the brief time that I had an opportunity to discuss it with them is that unless there is a reasonably rapid and reasonably broad based compromise on budget revenue items that it is incredibly unlikely that any country will come close to getting what they got last year in terms of assistance from this country, let alone any increase. What have you been telling them in that regard?

Mr. **Raphel**. Background might be useful. Last November Phil Gast and myself went out to Pakistan, had the first conversation, the first meeting on the follow-on programs. At that time we said that we were committed to another multi-year, follow-on program. The Pakistanis said, here is what our needs are. And it has been noted in the press they were talking about a program double the size of the present one.

The irony is it is justified in terms of the needs, in terms of the threat. At the same time we talked about the budget realities here in the United States. The Finance Minister just came to the United States, was here two weeks ago, the first elected minister to come. And the key item for discussion was the follow-on program.

Once again, he made a very eloquent case for Pakistan's needs, to which we did not take exception. We said with the dilemma we are faced with, everything you say is justified, but we will not have the resources to meet those needs. We used what the Secretary refers to as the Chairman's speech in terms of Gramm-Rudman and constraints. Although a significant increase is justified, we just do not see it in the cards right now while we face this current budget environment.

The Pakistanis were understanding of that. They have seen that these are the pressures and these are the realities. The dilemma they face is how are they going to meet their needs. But we have been very candid to them in explaining the budget realities.

Mr. OBEY. I understand the dilemma and understand their hope in light of the movement they have made toward opening up their political system somewhat, but they would like to see some response to that. But I think they have understand that certainly in this instance the resistance is based upon our evaluation of another need, our own, to pay for what we provide.

### PAKISTANI DEBT REPAYMENT

Pakistan is paying $111 million a year to the U.S. on FMS and other debts; is that right?

Lieutenant General GAST. Sir, in the CPD, on this page that I mentioned, it gives an account as to what they will be paying. According to my data, next year in '86 it will be $123 million. And it grows to $183 million in '88 and begins to go back down to $100 million in '95. That is on the loans that they will have accepted through '86 alone.

Mr. OBEY. In light of the needs that you say——

Lieutenant General GAST. We will be considering concessional credits for them in the follow-on program. Their FMS debt up through '84 was $560 million. You have to add another $325 million for '85 and another $311 million for '86 which is 5 percent of their total debt.

### REPAYMENT PROBLEMS

Mr. OBEY. When you consider this whole issue of the whole laundry list of countries who have tremendous repayment schedules in comparison to their ability to repay, what are we going to have to do about this long-term?

Lieutenant General GAST. There are three or four countries that are obviously facing repayment problems right away. One is Israel, as you know. The other is Egypt, and Turkey perhaps which had been rescheduled. I think, as Dr. Schneider has indicated, this is very much of a concern to the Administration and the Congress; there is no doubt about it. There have been various reviews of how to deal with the problem.

Perhaps one that will help for the future, in fact is helping now, is the initiative the Administration gained acceptance from Congress for in '85 to go on budget so we could offer concessionary funding. Largely concessional credits are perhaps warranted in Pakistan for the follow-on program, keeping that portion of the military debt of the overall debt to a reasonable level. It is not generally understood by a lot of people that there are very few countries at this stage where the debt for military assistance exceeds 10 percent. There are a few.

Mr. WILSON. 10 percent of what?

Lieutenant General GAST. Of their entire debt. I think many people believe the military debt is a huge portion of their foreign debt. We are very mindful about this in working with AID and putting together the President's budget, as to their impact.

In fact, whenever I travel, I assure you I talk to my military counterparts. We point out that the value of U.S. assistance should be looked at equally in the quality of the assistance that we provide as well as in the dollars. We can show in many countries, and I hope we will be able to show to Pakistan in the future, that providing the right kind of military assistance will bring a relief on their debt in the future.

That is our real objective. We have not found a way to forgive loans or to reschedule on a unilateral basis. But I think it is something we have to continue to evaluate.

### POLITICAL PARTICIPATION IN PAKISTAN

Mr. OBEY. I have three other questions I would like to submit at this point in the record. And then let me ask you this: in addition to the steps already taken in Pakistan to move away from the absolute control that the President and military have exhibited in the last few years, what else do we expect to see happening in Pakistan over the next few years to further broaden political participation? Can you give sectors other than the Army a real opportunity to participate and have a real effect in that society?

Mr. RAPHEL. One of the first acts of the new parliament was to pass a political parties bill. And the Prime Minister is a leader of the Moslum League grouping, which is now in effect the majority grouping in the parliament. Since the elections were on a nonparty basis, they are struggling among themselves within the parliament.

We fully expect within the next several years you will find more formalization of political parties and a continuing active level of political dialogue and activity in Pakistan. The step that they took on December 1st when they returned to democratic rule, is really a very significant one. And basically it is an open society now in terms of political engagement and involvement. The government has done what it has to do in terms of laws, and it really becomes a question of how the people respond to it.

Mr. OBEY. I have a number of other questions on this point which I would like to insert in the record. I wish Mr. Mrazek was here because he indicated an interest. And I am sure he will submit questions.

### PAKISTAN'S PURSUIT OF NUCLEAR ACTIVITIES

Last year I asked a number of questions with respect to what the Administration was doing to suppress Congressional concern over Pakistan's pursuit over nuclear activities. And he indicated I think we have driven home the message. What kind of assurances do we have from Pakistan in that regard?

Mr. **Raphel**. Both the Prime Minister and the President publicly said and privately said to us that Pakistan does not have a nuclear explosives development program, or a nuclear weapons development program. And we take those assurances very seriously. And we have gone back at a very high level to say we have concerns especially about unsafeguarded facilities in Pakistan.

We are confident that that message has sunk in at the highest levels in the Government of Pakistan. We are also confident that the fact of our security assistance program and that close tie with the United States has been the major impediment to Pakistan moving ahead toward a nuclear option. The key role has been a commitment from the United States and confidence in the United States and in our program.

At the same time I think both the Pakistanis and Indians see this as a regional issue. It is not just a single country issue. And we are concerned that in the long-term the only way to bring this issue to a final close, to have the nuclear genie competely under control in South Asia, is for the parties themselves to find some sort of regional accommodation.

We were very pleased in December when Prime Minister Gandhi and President Zia announced, for example, the policy of not attacking the other's nuclear facilities and the fact that the Pakistan atomic energy commissioner has traveled to India to meet his counterpart and talk. They are moving down the road toward some sort of regional understanding on this issue. We think that is really the key.

Mr. **Obey**. Last year I asked Mr. Peck about the Pakistani nationals who were charged with attempting to illegally export electronic switches that could be used in a nuclear device. And I asked what specific assurances we have been given by the Pakistanis to assure that they would not make any remotely similar attempts in the future and that they would not be engaging in any other efforts to violate U.S. law.

In response Mr. Peck said he would provide a response for the record. But we have never gotten that response.

I would like to know again what assurances we would receive from the government of Pakistan. If you could, I would like to know what you can tell me now.

Mr. **Raphel**. After this case we made our concerns directly known to the Government of Pakistan. We pointed out that the intensity of concern about the issue was shown by the passing of the amendment which was directed at this very case. As you know, Mr. Chairman, it calls for—this is paraphrased, but basically a cutoff of assistance if any country procures equipment which will substantially enhance its ability to produce nuclear weapons. And we pointed that out to the Government of Pakistan, saying this is a concern of the United States about this kind of issue.

We have also had private exchanges about which I would certainly be happy to brief you on in closed session.

Mr. **Obey**. Are we confident that they will not be making any further efforts along those lines which are in violation of U.S. law?

Mr. **Raphel**. We are confident that the message is well understood.

Mr. **Obey**. That is not my question. I send lots of messages that are well understood. But they sure as hell are on occasion not——

Mr. **Raphel**. No reason to believe that Pakistan is going to take action which would violate this law.

Mr. **Obey**. Any reason to believe that they will not?

Mr. **Raphel**. Good reason to believe they will not because of the importance of the program in Pakistan and their relationship with us.

Mr. **Obey**. I am running out of time and I have got some other questions on humanitarian assistance in Afghanistan, which I will ask you to answer for the record.

India, the largest democracy in the world, one of the poorest, we are providing for, what, $72 million, is that the right number for the economic side?

Mr. **Greenleaf**. That is right, on development assistance exclusively.

Mr. **Obey**. What do you contemplate that money being used on? I do not mean to suggest $72 million is small potatoes, but in the context of a country that large with problems that large, you wonder if something so small——

Mr. **Greenleaf**. Because the country is so large we try to focus what we spend on relatively few things. One major thing we are spending money on is irrigation and water management, which is a major need particularly in the western and northern parts of India, the dryer parts.

The second priority we have is dealing with family planning and health. In addition to that, our third priority is forestry, and in terms of size, these really constitute the vast bulk of the program. We felt we should focus the program both within those sectors and geographically primarily on the northern and western parts of the country. Even though food aid is disbursed throughout the country, DA is quite carefully targeted.

Mr. **Obey**. I have not been to India or Pakistan since 1980. So I have not seen the refugee camps in Pakistan since then. And I have not had any first-hand experience in the area. But, you know, one of the frustrating things to me was being in both countries and listening to people who had perfectly reasonable cases to make about their concerns about each other.

And in essence they are both arguing about what is going on in the back yard rather than looking at what Soviet action in Afghanistan could mean in the entire region. I understand India's reasons for wanting to remain unaligned, truly so. If I was in their position, I think I would want to do that too.

### RELATIONSHIP WITH INDIA

But my question is since Mr. Gandhi has taken power, how would you say relationship has changed with India, to what degree do you think it has changed? What opportunities do we see to open up a stronger relationship with the largest democracy in the world, really?

And what I assume you raised with them is our continuing frustration about their refusal to in anyway criticize the Soviets for their actions in Afghanistan, for their heavy reliance upon the Soviets for military weapons. What have you raised with them in regard to those questions? What do you see in their response that is different from past experience?

Mr. **Raphel**. The relationship has improved considerably over the last few years. Prime Minister Gandhi is very pragmatic, very practical, has as you know deep interest in seeing India develop technologically, economically, a very forward looking person. When he came here to the United States, he had a very good meeting with the President.

Our relationship has undergone improvement however. Since we signed the memorandum of understanding with India on technology transfer, I believe we entered into contracts of more than a billion dollars of high technology going to India just the first year. CDC has just signed a contract for half a billion dollars for mainframe computers for India. So in practical terms relationships there has been a lot of improvement over the past year, year and a half.

We have told the Government of India that we have a basic disagreement in terms of the Soviet occupation of Afghanistan. It is important to keep in mind that the Indians have never supported the Soviet occupation and spoken out against foreign adventure. But we said that we feel every one should speak out publicly and forcefully about what the Soviets are doing in Afghanistan.

However, what we continually relearn even with our friends, they do not always do what we think they should do. And I am sure we do some things they do not like. Where we disagree we do it openly and where we agree we try to build a relationship.

We do have those areas of disagreement, and we talk about them. But because we disagree on something like Soviet supply of military equipment to India, in our view that should not hinder building a relationship where we can.

Mr. **Obey**. I have a few other questions on India. And I have run out of time. Let me just ask a couple of quick ones and insert the rest in the record.

### ASSISTANCE TO SRI LANKA

Sri Lanka, our aid has fallen considerably there. Is it budgetary reasons, policy reasons? Are we dissatisfied with the way the government acts there? What is the reason for that.

Mr. **Greenleaf**. Two reasons, Mr. Chairman. One, and this is the primary reason, we had what could be termed a bulge in our aid to Sri Lanka over the last several years because of our participation in the multi-donor assistance effort to develop the Mahaweli Basin under which a number of dams and irrigation systems were built. The World Bank and other bilateral donors also participated very heavily in this program.

Aid levels to Sri Lanka over the last five years rose considerably, largely due to infrastructure investments in the Mahaweli. Since the major construction phase is coming to an end, it was expected the aid levels would go down.

Second, because of Gramm-Rudman reductions and the cutback in appropriation levels, the pace of this reduction was faster than we had planned.

## EFFECT OF AID PROJECTS ON ETHNIC GROUPS

Mr. **Obey**. One other question and then I have to leave. And I will leave the rest for the record.

Given the ethnic clashes that have going on, how sensitive have we been to the place of AID projects within that country? What would you say has been the effect of those AID projects on the ethnic groups in the country?

Mr. **Greenleaf**. I would like to comment on this, and also on the reverse, the effect of the situation on AID projects. The Market Town Water project in the Jaffna Peninsula area was cancelled when it became apparent we could not function there. You may recall, a couple of years ago one of the contractors and his wife were kidnaped. Although it was near completion, that project simply had to be closed down.

Although the Sri Lanka government has moved forward to try to complete this project, it still has not been completed.

The second area of concern would be in the north central part of the country, along the fringe of the Mahaweli Basin area. Planned downstream infrastructure work had to be shelved when it became apparent that completion of soil testing, required to determine economic viability, could not be completed due to the security situation. Activities under the Mahaweli Environment Project have had to be limited to more secure areas in the southern region.

We have tried in our AID program to the extent that we can, to operate in areas in which both Sinhalese and Tamils will benefit. By and large our program, with the exceptions that I have mentioned, has not been significantly affected by the communal strife. The government's plans are to develop the basin, which includes having both Tamil as well as Sinhalese people moving into the area which is presently rather sparsely populated.

I do not know if Deputy Assistant Secretary Raphel would want to make any further comments about the overall diplomatic relationships. But as far as the AID program is concerned, those would be the main points I would like to make.

## DEMOCRATIC PROCESS IN BANGLADESH

Mr. **Obey**. Bangladesh. Since the government has taken power, we have got a lot of questions raised about what is going to happen in terms of their own democratic process situation. The opposition party is talking about boycotting any elections.

What is happening there? What effect should those determinations have on our own program in that country?

Mr. **Raphel**. President Ershad has announced that elections will held on April 26, and we welcome the announcement. The opposition parties have threatened not to participate in the elections unless martial law is first disbanded, President Ershad steps down, and their government takes its place.

This obviously is an issue they have to work out among themselves. We have continually encouraged them to find a way to resolve this so they can move ahead and have a democratic government. We are convinced that is what President Ershad wants to do. It is just a question of working out arrangements with the opposition.

We tend to view our program, which is an all grant program, a basically humanitarian program aimed at the development of Bangledesh and we have not tied it explicitly to any kind of changes in the government structure.

Mr. OBEY. Anything else any of you want to add?

Well, I am two minutes late for another meeting, so I thank you for coming. I appreciate your time.

Lieutenant General GAST. Thank you.

## Questions for the Record

### HUMANITARIAN ASSISTANCE TO AFGHANISTAN

Mr. OBEY. In Fiscal Year 1986 Congress appropriated $15 million for overt humanitarian assistance to Afghan rebels. In addition, $8 million was made available through reprogramming during FY 1985. This year A.I.D. has requested $15 million in appropriations to continue the program.

Have you in fact established a mechanism for funding assistance to the Afghan Rebels?

ANSWER. Since our program to provide humanitarian assistance to war-affected Afghans is new and rapidly evolving we have opted to use several mechanisms, rather than a single one.

On the A.I.D. side, we have established the A.I.D. Representative for Afghanistan Affairs in the U.S. Embassy in Islamabad. All funds provided will be administered by this official who has been delegated authority and responsibility for this program.

Two project appraisal and design teams in the education and health sectors have identified several mechanisms for providing health services and assisting schools inside Afghanistan. The Afghan resistance alliance is expected to be the mechanism through which our assistance will flow. We expect the alliance to be the mechanism for the proposed livestock and commodity support projects as well. In addition, we are continuing to utilize the mechanism of private voluntary organizations for implementing health, education, food and livestock activities.

Mr. OBEY. It has been several months since the $15 million was provided. What is the stumbling block in releasing the assistance?

ANSWER. A.I.D. is now well along in developing a program and releasing funds for our humanitarian assistance for the Afghan people inside Afghanistan. The new program will provide assistance in health, education, livestock and commodity support. For example, we have already authorized the Technical Services and Support and PVO Co-Financing projects, two of the six new projects planned this year. We are proceeding to obligate funds for these two projects. We estimate that as much as $5 million of the $15 million will have been obligated by the end of April for the PVO Co-Financing project.

Mr. OBEY. Is the Government of Pakistan being cooperative in establishing the humanitarian assistance program?

ANSWER. We have no doubt that the Government of Pakistan shares our objective and their support for the Afghan cause is beyond question. Indeed, the free world has considerable admiration for Pakistan due to its steadfast support for the Afghan cause in the face of direct and indirect Soviet pressures these past six years.

The Government of Pakistan has cooperated fully with us since FY 1985 in implementing the $8 million short-term humanitarian aid program. They are also working urgently with us now to design an effective administrative arrangement that will assure the efficient channeling of the substantial additional sums Congress has recently made available.

### ACCOUNTABILITY FOR FUNDS

Mr. OBEY. Providing overt assistance to people inside Afghanistan certainly has potential problems of accountability. What steps are you taking to be certain that the funds reach those in need and are not kept by "middle men"?

ANSWER. We must recognize the inherent uncertainty of working under wartime conditions and that in a less than perfect situation, security conditions do not permit optimal monitoring. Monitoring procedures for activities inside Pakistan will comply with normal AID requirements. For activities inside Afghanistan, while we attempt to utilize normal AID monitoring procedures to the maximum extent possible, obviously certain areas and activities require modifications of normal controls.

For example, A.I.D. officers do not enter Afghanistan, but A.I.D. makes use wherever possible of a variety of methods and personnel for monitoring purposes which are tailored to each individual situation. The Conference Report on the authorizing legislation recognizes the need for this flexibility given the nature of the program.

### U.S. ASSISTANCE TO INDIA

*Question.* How does the level of assistance provided by the Soviets compare to that provided by the United States?

Answer. Government of India statistics for 1983-84 (Indian fiscal year) indicate Soviet project aid for India totaled $135 million in equipment and technical assistance for Soviet development projects. United States project aid in FY '84 was $87.5 million and $85 million for FY '85. The Soviet Union provides little in the way of commodity support, whereas we supplied $115 million in Title II PL 480 in FY '84 and $90.7 million in FY '85. The major portion of Soviet assistance to India occurs in concessional trade arrangements and concessional rates on military purchases, which are not included in the totals.

As of March 1984 the breakdown of cumulative aid for India was as follows:

| | *Percent* |
|---|---|
| World Bank | 40 |
| United States | 19 |
| United Kingdom | 9 |
| U.S.S.R | 6 |
| Other sources | 26 |

NOTE: Totals for the Soviet Union represent actual dispersed aid not the total offered.

*Question.* Has the U.S. taken steps to interest India in purchasing military equipment?

Answer. During Prime Minister Gandhi's visit last year, and on a number of other occasions, we have discussed ways to increase U.S.-Indian defense cooperation, including the sale of military and dual-use items. We believe that cooperation of this sort will strengthen U.S.-Indian relations and help India to diversify its sources of military supply. In the course of our discussions, we have made clear to the Indians the requirements of U.S. law and policy with respect to the protection of U.S. defense technology and systems. Indian interest in defense cooperation with the U.S. has focused primarily on equipment and technology to improve India's indigenous defense industry and research capabilities. We are not at this time discussing with India the sale of major military systems.

*Question.* Why does India purchase only Soviet equipment?

Answer. Indian purchases of Soviet weapons reflect economic considerations, including the ability to pay for Soviet equipment on highly concessional terms and in non-convertible currency, as well as the long-standing close Indo-Soviet political relationship. While the Soviet Union is still India's most important supplier of military equipment, the Indians have taken significant steps to broaden their sources of supply. For example, the Indians have recently purchased combat aircraft, ships, helicopters, field artillery, and other military systems from Western European countries. India is also making major efforts to become more self-reliant in the defense field.

*Question.* Has the Soviet invasion of Afghanistan had any effect on Soviet-Indian relations?

Answer. India continues to have good relations with the Soviet Union, bolstered by the Indian perception of Soviet support on issues of particular interest for India. Nonetheless, the Soviet invasion and occupation of Afghanistan has provoked concern in India—a nation that traditionally has feared actions which could lead to superpower conflict in South Asia. The Government of India did not condemn the Soviet invasion. India's official position is that it opposes both foreign "intervention" (read: Soviet troops) and "interference" (read: help to the resistance) in Afghanistan. India supports a negotiated settlement in Afghanistan and the GOI has assured us it has urged a political solution in its bilateral discussions with the Soviets. Indira Gandhi further stated publicly in Moscow during her visit there in September 1982 that "India has told the Soviets several times that we think that troops should be removed".

### U.S. ASSISTANCE TO PAKISTAN

*Question.* How do you now characterize the government in Pakistan?

Answer. Pakistan is now a constitutional democracy operating under a parliamentary system on a modified Westminster model.

*Question.* Have the elections (in Pakistan) produced a democratic state?

Answer. Yes. The National and Provincial Assemblies, whose members were elected in February and March 1985, are functioning with the powers granted them under the 1973 constitution, which—with its important guarantees of fundamental rights—came into full effect again with the lifting of martial law on December 30, 1985. Prime Minister Mohammed Khan Junejo is head of government and leader of the majority party in the National Assembly; he governs through a cabinet he appointed after martial law was lifted. President Zia remains as head of state and retains his position also as army chief. Last October, the National Assembly amended the constitution to validate most of the laws, ordinances, and regulations promulgated by the martial law regime since 1977, including President Zia Ul-Haq's five-year term in office, which will end in December 1989.

*Question.* In our negotiations with Pakistan are we stressing the importance of continued political reform?

Answer. Over the years since martial law was declared in 1977, we consistently encouraged Pakistan to move towards the restoration of representative, constitutional government which has now occurred. We believe our urgings and support have played a major role in the evolution which has now taken place. We have signaled our support for the changes and will encourage the government to continue this process. We are regularly in contact with federal and provincial officials regarding US human rights concerns, urging that religious freedom and civil rights be impartially available to all Pakistani citizens in accordance with the provisions of Pakistan's 1973 Constitution and in line with internationally-accepted norms.

*Question.* In view of our large aid program with Pakistan, is the (Pakistani) government taking sufficient action against the drug problem?

Answer. We believe the Pakistan government places a high priority on eliminating opium production and stemming the heroin trade in that country. Pakistan's elected leadership, in particular Prime Minister Junejo, has assured us that this program is of continuing importance for them, as it was for the martial law regime. Pakistani officials are aware of the rising numbers of addicts within Pakistan, and work to enforce narcotics regulations and cooperate with DEA in combatting international trafficking and heroin production.

The problem in Pakistan is complicated by the fact that large, indeterminate amounts of opium produced in Afghanistan and Iran are smuggled into Pakistan. As for poppy cultivation, it has been restricted to the tribal areas of the Northwest Frontier Province, a region only indirectly under control of the GOP. The GOP has persisted, despite the difficulties involved. For instance, this past month in response to new poppy cultivation in the Gadoon area of the Northwest Frontier Province (an area previously cleared with U.S. assistance) the GOP ordered government forces to go in and eliminate the new opium plants, despite local resistance from farmers who look upon the poppy as a valuable cash crop. The resulting clash resulted in the death of eight, and 32 others were injured.

Another indication of Pakistani involvement in anti-narcotics abuse efforts, are the continuing interest and leadership of President Zia's wife, Begum Zia. Begum Zia attended both conferences hosted by First Lady Nancy Reagan, and she has since played a significant role in rallying non-government organizations to enhance treatment and anti-drug education centers.

*Question.* The per capita income in Pakistan is only $390 per year (1983). Your security assistance request of $340 million FMS and $250 million ESF is quite substantial compared to only $25 million in development assistance. Why is the program so out of balance?

Answer. Our assistance package was specifically designed to ease the financial burden on Pakistan imposed by the necessity of modernizing its defense forces in the face of the continuing Soviet threat, while promoting economic growth. Both ESF and DA have been used to import essential commodities in support of policy reforms to meet economic development needs in such basic areas as agricultural production, irrigation, energy and the social sectors. Development in these areas is critical to a low income country such as Pakistan. We also have a substantial PL-480 program which supplies needed food commodities.

The FY-87 total request for DA, ESF and PL-480 is $325 million. We had planned for FMS also totalling $325 million in FY-87, but have added $15 million to offset the $15 million FMS shortfall in FY-83, thereby permitting us to complete our multi-year program with Pakistan at or near committed levels.

### U.S. AID PROJECTS IN SRI LANKA

Mr. OBEY. Where are U.S. aid projects in Sri Lanka located with respect to the population distribution of Singhalese and Tamils? Can you otherwise clarify the effect of U.S. aid projects in terms of benefits to the principal ethnic communities.

ANSWER. As a result of the unsettled conditions in the Tamil dominated north and eastern sections of Sri Lanka, most U.S. aid projects now tend to be physically located in areas which are predominately Singhalese. This is a relatively recent development. For example, the Market Town Water Supply project located in Jaffna was terminated last year when it became evident that the purpose of A.I.D.'s assistance could not be attained due to the security situation in the project area. Because of the security situation, work underway under the Mahaweli Environment project has been limited to more secure areas in the southern region and under the Reforestation and Watershed Management project, a planned facility to have been constructed in Trincomalee has been relocated to Nuwara Eliya and other activities have been reduced.

With the exception of activities in the Mahaweli Basin, U.S. aid projects are focused on building national capacity to carry out development activities throughout Sri Lanka. For example, the Irrigation Systems Management Project will develop the institutional capability to increase food production from existing irrigated lands. The planned projects sites are located in both Tamil and Singhalese populated areas in the east central region of Sri Lanka. Other projects, such as the Agriculture Planning and Analysis project, the Development Management Training project, the Water Supply and Sanitation Sector project and the Private Enterprise Promotion project, have a national focus aimed at improving institutional capacity in providing services and promoting the welfare of all Sri Lankans, including Tamils, Muslims and Singhalese.

In the Mahaweli Basin, President Jayewardene in September 1985 reiterated his government's policy that land allotments in the large-scale national settlement schemes would be apportioned on the basis of overall national ethnic ratios. Accordingly, Singhalese should receive 74 percent of the allotments, Tamils 18 percent, and Muslims 7 percent under the Mahaweli program. In practice, this has been difficult to achieve due to the communal tensions between Tamil and Singhalese populations settled in the area to date.

## Questions from Mr. Mrazek

### INDIA

*Question.* In August 1984 the Congress appropriated $110 million in Indian rupees to endow a bilateral fund to finance educational, cultural and scientific cooperation between the U.S. and India through the end of this century. The Indians have reportedly resisted establishing the fund and negotiations have moved very slowly. What is the current status of the negotations? How will the funds be divided among the different U.S agencies that conduct rupee-financed programs in India?

Answer: We have made progress in negotiations on the U.S.-India Fund. This development was welcomed in the communique of the Economic-Commercial Sub-Commission of the Indo-U.S. Joint Commission, which met on March 17-18. The mechanism for apportioning the funds is one of the elements under discussion. Both sides agree, however, that the activities funded in the past should continue to be funded.

*Question.* There have been reports that the US will allow an American-manufactured supercomputer to be sent to India for monsoon research. What assurances have the Indian Government given that the computer will not be used for nuclear weapons research?

Answer. The assurances and safeguards to be requested in the case of a possible supercomputer export to India are still under study in the USG. A primary consideration will be to assure the supercomputer could not be used for nuclear weapons research, as well as to assure the security of the technology against unauthorized access.

*Question.* In May 1985 the U.S. concluded a technology transfer MOU with the Indian Government. One purpose of the MOU was to insure that U.S. technology would not be used for nuclear weapons research. Is the Administration considering negotiating a similar MOU with Pakistan? Have the Pakistanis suggested such an agreement?

Answer. The Government of Pakistan has formally requested that we enter into negotiations toward concluding a technology transfer MOU. We have indicated our willingness to enter into negotiations, and tentatively plan to begin talks with the Pakistan Government before the end of 1986.

THURSDAY, MARCH 13, 1986.

## MULTILATERAL DEVELOPMENT BANKS

### WITNESS

### JAMES A. BAKER III, SECRETARY OF THE TREASURY

Mr. OBEY. I would like to welcome this morning Treasury Secretary Baker, as the Administration witness appearing on behalf of the Administration's request for the Multilateral Development Banks in the FY '87 fiscal year budget.

Mr. Secretary, as I have indicated to you on past occasions, I have a great deal of respect for you. I think you are a first rate professional and I think you are a credit to the Administration you represent, and I think we have a lot of similarities in views in terms of our concerns about our responsibilities vis-a-vis the Third World and the interrelated nature, or I should say, the interrelated impact of our economic forces on the Third World. Any disagreements that we have are certainly not personal ones; they are based on I think strongly held views about what the country needs. We have gone through this once before.

Before you begin your statement this morning, I simply want to put in perspective what this Committee is going to have to deal with. I just came from the Democratic Whip meeting this morning at which we discussed the fact that the House will be voting on the President's budget today. It will be a straight up or down vote and I assume it will not get a good deal of support.

What I would hope would happen after that vote, of course, is that rather than the House and the Senate going through an Alphonse and Gaston act on the budget resolution, I would hope that if the Administration budget goes down today, and I expect it to, I think that really says one very simple thing, the Administration can't pass its budgets and we can't pass our. I doubt that the Senate can pass a budget resolution on its own without revenues of some kind, although they may demonstrate that I am wrong.

But I really would like very much to see that whole process short-circuited by about six months so that the other committees around here, other than the Budget Committee, can deal with the reality rather than simply waiting for somebody to wave a magic wand to finally put a deal together.

The programs that you are going to testify for here today are in my view the top priority programs in this bill. I think that long term they do more to defend the interests of the United States than any other, almost any other proposal or program in the bill.

But the fact is that I honestly believe that as much as I strongly favor these appropriations, I honestly do not see how this Subcommittee can appropriate one dime for international banks as long as we do not have a compromise at the very top levels of the government between the President and the two Budget Committees so that we have some allocation of priorities that we think represents American values.

When you take a look at the fact that the President's budget is asking us to reduce cancer research by $70 million, reduce heart disease research by $62 million, reduce AIDS research by $30 million, reduce job training by 17 percent, eliminate 250,000 student loans this year at home, and eliminate school lunch funding for two million poor kids as well as a lot of middle class schools, 14,000 schools are estimated to be planning to throw out the school lunch program if the President's budget passes.

Under those circumstances, I think this committee is in a real box. I think this is the most able Appropriations subcommittee pound for pound, since some of us have lost weight, of any subcommittee in the House. I am very proud of the talent of this subcommittee.

Mr. **Yates**. He is leading up to a vote.

Mr. **Obey**. I don't think that we can pass a foreign aid bill which funds anything except our Middle East obligations with our Camp David obligations, without some kind of compromise at the top. I am not saying that to be obstreperous, I am saying it because I honestly believe it and our problem is that this year we can't pass a continuing resolution. We have to bring the bill out under Gramm-Rudman, we have to bring out all the appropriations bills before July. That means members are going to be asked—I know what will happen if they voted for any foreign assistance proposal, they will go home and people will say what in God's green earth are you doing cutting education here at home, cutting nutrition here at home, you are gutting environmental programs here at home, but you are funding education and health care and environmental programs abroad—and I just don't think it can sail.

As you know, the banks have been tremendously controversial, support for them in the main during the past history of their consideration by this Committee has come from this side of the aisle, not that side of the aisle, with one or two notable exceptions, Mr. Conte has been a great friend of the banks. But on substance, I want to help you all I can. I just have to tell you, as I told Secretary Shultz last year, I told the Administration, we would cut a billion dollars out of their military aid program. They didn't believe it. We did it. And I am flatly telling you that I don't see any way that we can fund any portion of this bill save the one that does have support on both sides of the aisle—the Camp David portion of foreign aid.

Unless we get that compromise, we need that compromise early or at least in terms of House consideration of foreign aid, even in the teeth of the best possible cases that can be made for the banks, I don't see the votes to save a dollar for them. That is the way I see it, as we begin consideration of these.

Please proceed to make whatever remarks you care to make and we are very happy to have you here.

Secretary **Baker**. Thank you very much, Mr. Chairman.

We, I am sure, will have an additional opportunity to discuss the fundamental questions that you have posed. I would like, if I might, to read a summary of the written statement and ask your permission to have the written statement inserted in the record.

Mr. **Obey**. Sure.

Secretary **Baker**. I am pleased to have the opportunity to appear before this subcommittee again. You are quite right, we to some degree had this debate several weeks ago when I appeared before the Joint Economic Committee. If I might present just a brief summary of the Administration's approach to the Multilateral Development Banks, which I think, Mr. Chairman, has been developed in the context of our serious budget constraints and some serious international economic problems. We are not sticking our heads in the sand with respect to either of these problems.

We all agree that we will have to make some tough decisions regarding the budget. We have got to find a way to get the deficit under control and we have to find a way to reduce it. Funding for the Multilateral Development Banks should be examined carefully as we begin this process. I think that the budget request that we have submitted for the Multilateral Development Banks—that is the only part of this foreign aid budget, of course, for which I have responsibility, and to which I can speak with authority—has been developed consistent with this position.

We have subjected our Multilateral Development Bank budget proposals to careful scrutiny. With one exception, we are asking the Congress in fiscal year 1987 to fund agreements which have already been made only after close consultation with the Congress on these agreements, and I think it is important that the United States keep its word.

We are also negotiating future Multilateral Development Bank replenishments in light of the budget environment and resources requirement of the institutions. As an example, we are resisting pressure from other countries for early consideration of a new general capital increase in the World Bank. We think that a new GCI at this time is premature.

The only new fiscal year 1987 budget item that we are proposing is the MIGA or Multilateral Investment Guarantee Agency. We are seeking new funding which is likely to involve a one-time outlay of $22.2 million: because we believe the MIGA will play a critical and cost effective role in reforming the international investment climate and in stimulating direct investment flows to debtor countries badly in need of capital.

We believe any examination of the budget request for the Multilateral Development Banks must take into account our national interests. The Multilateral Development Banks play a key role in our global economic strategy and are particularly important now when we are confronting a serious international economic crisis which threatens to jeopardize our economy and the international financial system.

During the World Bank and IMF annual meeting last year, I proposed a program to address this crisis. That program which concentrates our efforts on the necessary steps to promote sustained economic growth, has been accepted by the commercial banking community, the international financial institutions, other industrialized countries, and the developing country debtors themselves.

The program involves three mutually reinforcing elements to improve growth in debtor nations; credible, growth oriented reforms by debtor nations, supported by $9 billion in additional disbursements by Multilateral Development Banks over the next three years, and $20 billion in net new commercial bank lending over the same period.

We are not asking the Congress to spend taxpayers dollars to bail out the commercial banks, and we are not asking them to spend taxpayer dollars to bail out debtor countries. Rather, the debtor countries themselves must take necessary measures of economic adjustment to get their houses in order; and it is in the interest of the commercial banks to respond by lending to those countries which are willing to adopt appropriate economic reforms.

While other participants in this program will have to do their part, we also need to do ours. A key element is to ensure that the Multilateral Development Banks are able to perform their role. Congressional support for the Multilateral Development Bank budget request is essential of course to this effort.

The Multilateral Development Banks, working closely with the IMF, are the primary institutions with the leverage and expertise to work with countries on establishing a necessary economic policy to foster sustainable, economic growth. Also, of all the international economic institutions, the Multilateral Development Banks are the most cost effective from a United States budgetary perspective. One dollar of budget authority approved by this committee for the World Bank translates into $60 lending authority.

Mr. Chairman, we can't duplicate that kind of leverage on a bilateral basis. We need the Multilateral Development Banks as part of our international economic strategy.

The MDBs are also very effective in providing financial resources to countries of importance to us. For example, in FY 84, total lending from the Multilateral Development Banks was almost $23 billion. Of that amount, $15.6 billion went to countries receiving United States foreign assistance, and another $4.6 billion went to countries which are of strategic importance to us—such as Mexico, Argentina, Brazil, and Korea—but which did not receive any bilateral assistance. In other words, 88 percent of the Multilateral Development Bank lending went to countries of significant importance to the United States.

If the Multilateral Development Banks are to play a role in policy reform—and we have made policy reform a critical element in all replenishments and in MIGA—they must have adequate funding and they must have United States support.

However, they will not be perceived as having United States support if we do not honor past commitments.

We are the leaders in asking Multilateral Development Banks to play a role in reforming policies of borrowing countries, but we will not be seen as credible if, while we are pressing for policy reforms, we renege on commitments which have been carefully worked out in the past.

This Administration has worked with this committee over the last five years to promote reforms in the Multilateral Development Banks. In our opinion, these institutions have improved their performance and they have instituted some of the reforms that we have proposed. Multilateral Development Banks now focus more on macroeconomic policies and their impact on projects, and are making significant efforts to strengthen the private sector. They are also taking greater account of other important areas such as the environmental impact on their projects. I want to commend this committee for its role in sponsoring legislation which focuses on the environment.

In conclusion, I would urge this committee to support our budget request to assure that the Multilateral Development Banks play a vital role in addressing the serious fundamental problems of the international economy. I hope I can count on the committee to assist us in securing the necessary support.

I would also like to take this opportunity to underline the importance of another Administration request which is before this committee. I refer to the Fair Export Financing Program, which is the President's proposal for a $300 million war chest to combat predatory tied aid credits. The war chest is a key element of our attack on foreign unfair trade practices. It is essential if we are to persuade other countries to accept limits on the commercial abuse of such credits.

We have drafted a proposal which is cost effective and which will specifically target those users of tied aid credits delaying a negotiated solution. Authorizing legislation has been introduced in both Houses of Congress, and we hope that a final product will be approved very soon. I would appreciate the committee's prompt and sympathetic attention to this request.

Thank you.

[The statement of Secretary Baker follows:]

STATEMENT OF THE HONORABLE
JAMES A. BAKER, III
SECRETARY OF THE TREASURY

BEFORE THE
SUBCOMMITTEE ON FOREIGN OPERATIONS
OF THE
COMMITTEE ON APPROPRIATIONS
U.S. HOUSE OF REPRESENTATIVES
MARCH 13, 1986

Mr. Chairman and members of the committee:

I welcome this opportunity to discuss with you the Administration's budgetary proposals for the Multilateral Development Banks (MDBs) for fiscal year 1987.

Since taking office, the Administration has stressed the importance of sound, market-oriented policies to achieving economic development. Today, I would like to review this issue; to discuss its importance in the Administration's initiative to encourage growth in many developing countries now contending with high debt service payments; and to stress the cost effectiveness of MDB operations.

## Program for Sustained Growth

Last October at the annual meetings of the World Bank and IMF, I outlined a U.S. proposal for addressing the problems of debt ridden developing countries -- the "Program for Sustained Growth". This three-point program aimed at improving debtors' growth prospects builds on the current case-by-case debt strategy and involves the following elements:

(1) credible policy reform by the debtor nations;

(2) an enhanced role for the international financial institutions, particularly the World Bank; and,

(3) significant net new lending from the commercial banks.

Stronger and sustainable growth in the debtor countries is essential to solving the debt problem. Achieving this objective, however, requires recognition by the debtor countries themselves of the need to adopt growth-oriented economic policies. Absent appropriate economic policies, no amount of money -- whether derived from external borrowing, foreign aid, or domestic monetary expansion -- will produce sustained growth.

The types of policies required for stronger and sustainable growth are:

- the privatization of burdensome and inefficient public enterprises,
- the development of more efficient domestic capital equity markets,
- growth oriented tax reform,
- improvement of the environment for both domestic and foreign direct investment, and
- trade liberalization and the rationalization of import regimes.

Many of these touch sensitive political issues, and their benefits may become visible only over the longer term.

Role of the MDBs. The MDBs, in particular the World Bank and the Inter-American Development Bank (IDB), are expected to play a central role in this initiative. We have also asked the IMF to give more thought to growth-oriented policies and this is being done. But the IMF's central mission is not that of a development institution. It concentrates on relatively short-term balance of payments programs. Hence, the Fund's contribution to longer-term reform efforts is necessarily somewhat limited and indirect. The MDBs on the other hand, are more strongly focused on longer-term development issues, and thus are in a better position to deal with the longer-term structural problems most debtor countries face.

The expanded role for the MDBs that this Program foresees, in particular the roles of the World Bank and the IDB, will also require important policy and procedural changes in these institutions. These changes may be difficult but are indispensable if these institutions are to significantly expand their policy-based, fast-disbursing lending.

For example, it will be essential to improve and strengthen conditionality. Any substantial increase in fast-disbursing lending which fails to maintain loan quality will result in a serious risk of over-exposure and a diminished international credit standing.

The World Bank already has experience in addressing some of the types of structural problems that most debtor countries face. Much of the World Bank's new lending will be fast-disbursing sectoral and structural adjustment loans. We believe the World Bank has ample capacity to increase lending commitments by some $2 billion per year over the next three years and to concentrate that lending more heavily on the large debtors with credible reform programs. We are also prepared, if all the participants in the strategy do their part and there is a demonstrated increase in the demand for quality lending above these levels, to consider a general capital increase for the World Bank.

In this context our ongoing and past efforts to strengthen MDB policies take on an ever great importance.

## Strengthen Economic Policies

From the outset this Administration has emphasized that a fundamental role of the MDBs should be to encourage policy reform in developing countries. This was a central theme of the Administration's assessment of the MDBs, published in 1982. This general theme, which we have emphasized with the MDBs and with the major donor countries, is translated into four main areas:

-- improved loan quality
-- privatization
-- country strategies, and
-- adjustment in lending terms.

### Loan Quality

We have had a measure of success in our continuing efforts to improve loan quality. We have pushed the MDBs to focus more on how overall macroeconomic policies impact on projects, and they have responded by broadening their examination to include all of the variables in the economy, e.g., interest rates and exchange rates, not just those traditionally in their preview -- e.g., user charges and farm-gate prices.

Our chief concern now is that too often the MDBs yield to borrower intransigence on improving loan quality issues. For instance, an unwillingness to rationalize uneconomic public utility rates or import tariffs. This is particularly true toward the end of a fiscal year when the question becomes one of making a loan or not. We want a greater resolve by the MDBs to seek strong, economic loan conditions; and an increased willingness by the MDBs to refuse funding when these conditions are not accepted, or, once accepted, are not met.

## Private Sector

The MDBs are doing much more to promote the private sector. The Asian Development Bank (ADB) established a private sector unit, which has started a limited program of lending to the private sector without guarantees. The World Bank has been in the forefront in convincing governments, particularly in Africa, to restrict their role in the economy. Overall, the MDBs are focusing more on the private sector. Now the Administration wants each of the MDBs to enhance their operations to promote private sector development, i.e., to devise ways to emphasize the private sector in preference to the public sector. Possibilities include intermediating loans between the foreign and domestic private sector, having parastatal enterprises become more responsive to market forces, and where appropriate, selling off all or part of the state's interest.

We recognize there are honest differences of opinion regarding the role of the state in some sectors of the economy -- such as utilities and telephone service. But we cannot allow these unique sectors to obscure the fact that in most industries, government ownership is disruptive, inefficient, and is not required. In our opinion, the MDBs must confront these cases head-on.

## Country Strategy

All of the MDBs produce lending plans for borrowing countries that set out to varying degrees the resource base and the policies -- taxing, pricing, regulations, investment climate, etc. -- which will best exploit market opportunities in those countries. Too often, however, there is an insufficient connection between country strategy documents and lending. We believe country strategies must serve as a broad guideline in the preparation of individual loans, and should not be undermined. Better coordination on country strategies between the MDBs, bilateral donors and borrowers is needed. In particular, country strategies must be worked out thoroughly with the developing countries to have their full support -- without their support this will not work.

## Lending Terms

Finally, we are suggesting moderate changes in concessional lending terms. This includes a reduction of maturities and grace periods, repricing during a loan to reflect changes in a borrower's economic circumstances, and establishment of a small interest charge. Other donor countries have been generally supportive of our desires to reduce maturities and grace periods, and to provide for repricing of future loan contracts.

However, they are strongly resisting our request to charge modest interest rates. We will continue our discussion on these issues with other donors during the course of the ongoing replenishment negotiations.

## The Multilateral Investment Guarantee Agency (MIGA)

Consistent with these efforts to strengthen economic policy, the Administration has supported the creation of the Multilateral Investment Guarantee Agency (MIGA), and is requesting Congressional support and approval of the MIGA. The MIGA will promote reform of developing countries investment policies, enhance the private sector's contribution to the development process, and encourage the flow of non-debt capital to developing countries. Its strong mandate to promote policy reform in developing member countries will be a valuable addition to the programs we are using to promote policy reform through the multilateral development banks. In addition, by stimulating the flow of private direct investment to developing countries, the MIGA can be an important component in our international debt strategy by furthering our objective to enhance the role of the private sector in developing countries and the movement toward equity vs. debt capital in these countries.

U.S. membership in the MIGA will also advance our national interests. The United States, as the largest international investor, has a major stake in seeing that appropriate standards for investment protection are developed. Due to its multilateral nature, the MIGA will be better positioned to promote reforms than OPIC or other national insurance agencies, which focus on individual transactions to increase the competitiveness of their investors. This will be a small, cost effective operation requiring little funding. In return we will secure an important new instrument for promoting an improved international economy.

Thus, the Administration believes that the United States should move expeditiously to join the MIGA and seeks authorization and full funding of U.S. membership in the FY 1987 Budget. The $222.0 million U.S. subscription -- which is 20.5 percent of the total -- will include $44.4 million of budget authority of which $22.2 million is to be paid in cash and $22.2 million is to be in the form of non-negotiable non-interest bearing promissory notes. The remainder of the Administration's request is for $177.6 million of callable capital under program limitations. I want to emphasize that this is a one year appropriation; we do not envisage additional budget requests.

The MIGA will be a valuable addition to the multilateral institutions because it is uniquely positioned to further our policies toward development in developing countries as well as serve our own economic interests. Support for its creation comes not only from the Administration; it has also attracted broad endorsement from the private sector. I therefore urge that the Congress enable us to move expeditiously to become a founding member of the MIGA.

## Environment

Mr. Chairman, another critical area of interest regarding MDB policies and operations is the environment. You have expressed concern about the negative impact of some MDB projects on the environment. The Treasury Department has found that MDB performance in this area is mixed, and has expressed its concern in meetings with senior management at the MDBs, and with other member countries. Major problems have surfaced in such projects as dams, penetration roads into relatively undeveloped areas, and agriculture and rural development. Too often, if environmental considerations threaten expeditious project financing, the environment is assigned low priority and is left to be dealt with later. We believe projects in environmentally sensitive sectors should only be accepted if environmental aspects have been thought through, and if measures necessary for sustainable development have been identified and any necessary funding assured. We are carrying out the requirements which you placed in the FY 1986 appropriation act and will be responding to you in detail in the near future.

## Cost Effectiveness of the MDBs

It is important to emphasize that while we are seeking changes in the MDBs, they are very important to the conduct of U.S. foreign and economic policy; and they are performing better. Hence, it is in our own self-interest to assure they are adequately funded.

The cost to the United States of trying to duplicate bilaterally what has been achieved multilaterally in the MDBs would be prohibitive. Through 1984 the MDB hard loan windows have made total loan commitments of $133.1 billion at a cost to the United States of only $2.4 billion. The soft, concessional loan windows have made $50.6 billion in loan commitments at a cost to U.S. taxpayers of $14.8 billion. As we have pointed out previously, most of the countries that receive allocations from the State Department's Economic Support Fund (ESF) also receive MDB support. Three countries that receive ESF but no MDB assistance -- Israel, Italy, and Spain -- have per capita incomes too high to qualify as MDB borrowers. Interestingly, there are a number of countries of strategic importance to the United States -- e.g., Argentina, Brazil, and Mexico -- that receive substantial MDB support, but no ESF at all.

It is true that MDB programs do not always live up to the high standards we and the MDBs themselves have set. That is why we are trying to exercise our leadership in directing how the

MDBs can improve their operations. Through our leadership we have been seeing a better product. However, we can only maintain our leadership position if we are willing to bear what the other members mutually perceive to be our fair share in supporting these institutions. We cannot have it both ways, i.e., we cannot for long place more of the burden of fostering and enlarging the international economic system on the MDBs and other international organizations, and then refuse to support them adequately.

Currently we are negotiating replenishments with all of the MDB groups. We have been consulting with the Congress regularly during these negotiations to ensure we are taking into account your views. We will continue these consultations as the negotiations proceed.

These replenishments and aspects of the U.S. debt initiative indicate a potential need for increased resources for the MDBs which is at variance with our current budget environment. The Administration's fiscal year 1986 request for the MDBs was reduced by $228.8 million by Congress in the Continuing Resolution; implementing Gramm-Rudman-Hollings reduced it another $48.1 million. The funding requests reflect a commitment on the part of the United States Government. We have an obligation to our friends and allies to honor these commitments. We will be seeking your support for appropriating these shortfalls.

We are currently discussing with the Department of State and OMB how best to handle these shortfalls in MDB funding. I would urge your support in this effort and ask that you not compound the problem with additional reductions in the FY 1987 budget request for the MDBs.

## The Fiscal Year 1987 Budget Request

Our MDB fiscal year 1987 request is composed almost exclusively of funding requirements negotiated by this Administration in close consultation with this Committee.

These funding proposals reflect both the need for budgetary restraint and the financial requirements for effective development programs. The fiscal year 1987 request is for $1.4 billion in budget authority and $3.8 billion under program limitations for callable capital.

### International Bank for Reconstruction and Development (IBRD)

For the IBRD in fiscal year 1987, the Administration is requesting: 1) $109.7 million in budget authority and $1,353.0 million under program limitations for subscriptions to the sixth installment of the 1981 GCI; 2) $65.7 million in budget authority and $685.5 million under program limitations for subscriptions to the first of two installments to the IBRD's 1984 Selective Capital Increase (SCI); and 3) $7.4 million for paid-in capital subscriptions and $66.7 million in program limitations for callable capital subscriptions to the 1970 SCI.

The 1984 SCI totals $8.4 billion and was unanimously approved by the IBRD Executive Board in May 1984. This SCI adjusts members' relative shares to reflect their relative position in the world economy. U.S. participation is the parameter of U.S. support for the World Bank and our willingness to work cooperatively with other donor countries to strengthen the World Bank's financial position and ensure improved cost-sharing.

The Administration continues to believe that the IBRD should play a prominent role in the longer-term development programs of its borrowers and regards "equitable cost-sharing" among donors to be a key element of our participation in all of the MDBs. An important consideration for the United States in negotiating the SCI was the general understanding to maintain a conservative interpretation of the IBRD's "sustainable level of lending" (SLL).

### International Development Association (IDA)

For fiscal year 1987, the Administration is requesting $750 million for the third installment for the $2.25 billion U.S. share of the $9 billion Seventh Replenishment. We are pleased at the speed with which the World Bank has moved, with full support of the Executive Board, to strengthen the administration and management of its African operations, with the object of supporting policy reform efforts in this region. We continue to believe the countries of Sub-Saharan Africa and other least developed countries should have first claim on available IDA resources as long as these countries are able to make effective use of these resources.

### International Finance Corporation (IFC)

For fiscal year 1987, the Administration is seeking $35.0 million for the second of five installments on the U.S. subscription to a $650 million IFC capital increase unanimously approved by the IFC Executive Board in June 1984.

This capital increase is needed to support an IFC five-year plan for the period FY 1985-1989 that is consistent with the direction and emphasis the United States has encouraged the IFC to take.

Multilateral Investment Guarantee Agency (MIGA)

As mentioned above, for fiscal year 1987, the Administration is requesting $44.4 million in budget authority and $177.6 million under program limitations for the U.S. subscription. Of the budget authority, half ($22.2 million) will be paid in cash and half will be in the form of non-negotiable, non-interest bearing promissory notes that will be treated like callable capital.

The MIGA is a new international institution designed to encourage the flow of investment to and among developing countries by issuing guarantees against political risk, carrying out a wide range of promotional activities and encouraging sound investment policies in member countries. Foreign direct investment, which the MIGA will accelerate, can be a direct substitute for official financial flows. The Administration has strongly supported the creation of this institution and believes that the United States should move expeditiously to join it.

Inter-American Development Bank (IDB)

For fiscal year 1987, the Administration is requesting $58.0 million in budget authority and $1,231.0 million under program limitations for the fourth installment. The lending program based on the 1983 capital increase is designed to continue strong support for the long term development of the countries in Latin America and the Caribbean.

Fund for Special Operations (FSO)

For fiscal year 1987, the Administration is requesting $72.5 million for the fourth installment. The FSO replenishment is designed to address the long term development needs of the poorest countries, primarily in Central America and the Caribbean.

Inter-American Investment Corporation (IIC)

For fiscal year 1987, the Administration is seeking $13 million for the third of four installments to the IIC. The Administration strongly supported establishing the IIC as a practical means of enhancing the capacity of the IDB to aid the private sector in borrowing countries. The investment program will provide loans and equity participation for small- to medium-sized privately controlled firms in Latin America and the Caribbean.

Asian Development Bank (ADB)

For fiscal year 1987, the Administration is seeking $13.2 million in budget authority and $251.4 million under program limitations for the fourth of five installments for the 1983

General Capital Increase. The ADB is a key institution in one of the most economically dynamic and politically sensitive regions of the world. Active and positive U.S. participation has served U.S. interests.

Asian Development Fund (ADF)

For fiscal year 1987, the Administration is requesting $130 million for the fourth installment to the third replenishment. The ADF has supported well designed and effective development projects in some of the poorest countries in the world. U.S. support benefits the people of such countries as Pakistan and Sri Lanka as well as many of the strategic island countries in the South Pacific.

African Development Bank (AFDB)

For fiscal year 1987, the Administration is requesting $18.0 million in budget authority for subscriptions to paid-in capital and $54.0 million under program limitations for callable capital for the fifth of five installments for the initial U.S. subscription to the AFDB.

The AFDB is visible evidence of U.S. commitment to work with the countries of Africa for the achievement of their long term development objectives.

African Development Fund (AFDF)

For fiscal year 1987, the Administration is seeking $75 million in budget authority for the second of three installments for the U.S. contribution to the fourth replenishment. During the period of the fourth replenishment, 85 percent of AFDF lending will go to the poorest African countries. Fund lending will continue to be focused on agriculture with 40 percent of the replenishment resources going to this sector. The remainder of AFDF lending will go to high priority projects for transportation, health, education and water supply.

The substantial increase in the U.S. contribution to the AFDF is a reflection of the Administration's belief that concessional development assistance should be focused on the poorest countries, particularly those of Sub-Saharan Africa.

## Fair Export Financing

In addition to our MDB requests, Mr. Chairman, we are seeking funding for the Fair Export Financing Act, which is the President's proposal for a $300 million "war chest" to combat the trade distorting use of tied aid credits.

Tied aid and partially untied aid credits offered by the governments of other countries are a predatory means of financing exports. The market-disrupting effects of these practices have caused the United States to lose export sales. These practices also impede the growth of developing countries to the extent that they divert funds away from legitimate development assistance.

The Administration has proposed an agreement in the Organization for Economic Cooperation and Development that would require at least 50 percent of any such credit to be in the form of a grant. That minimum grant element would make these credits so expensive to use that in practice they would be limited to real foreign aid. We have succeeded in raising the minimum grant element from 20 to 25 percent, but have been blocked from imposing greater discipline over tied aid credits.

Nearly all other OECD members agree that the figure should rise. However, a few countries remain which have so far resisted efforts to negotiate an effective end to this predatory concessional financing.

The "war chest" proposal seeks to strengthen the U.S. negotiating position through an appropriation in the amount of $300 million for the creation of a temporary tied aid credit facility in the Department of the Treasury. The facility would be used to provide grants tied to Export-Import Bank and/or private credits targeted at the export markets of those countries which engage in such tied aid and partially untied aid credits and which block progress toward an arrangement to restrict tied aid credits. This facility could support up to $1.0 billion in tied aid credit authorization.

It should be emphasized that this facility would be used selectively to provide leverage to the Secretary of the Treasury in negotiating the elimination of predatory and trade distorting financing by other countries. Under our budgetary constraints, we cannot hope to provide enough assistance to all of our exporters to allow them to match effectively the tied aid offers of foreign competitors worldwide. We have drafted our proposal selectively, in a cost-effective fashion, so that we can specifically target those users of tied aid credits delaying a negotiated solution. Only a negotiated end to the practice will provide the kind of relief and a level playing field that all of our exporters deserve.

Authorizing legislation has been introduced in both Houses of Congress, and hearings have been held. We hope that a final product will be approved very soon. I hope that this Committee will also give prompt and positive attention to the request.

## Conclusion

In conclusion, Mr. Chairman, I want to emphasize the Administration's commitment and full support for the MDBs. They play an important role in U.S. foreign and international economic policy. Now, we are asking them to take a more active part in supporting growth-oriented policy reform in the developing countries -- to play a central role in implementing the "Program for Sustained Growth". Successful implementation of this program will be very helpful to the U.S. economy; it will increase effective demand among developing countries for U.S. exports, and will reduce the strains on the international financial system by helping developing countries reduce their debt service obligations to more manageable proportions.

I recognize fully that even in the best of circumstances supporting foreign assistance is never popular. Now, at a time of severe budget constraint, it will be even more difficult. But I strongly believe that if we do not firmly support the MDBs now, we may have to resort to more costly measures later.

Mr. OBEY. Thank you, Mr. Secretary.

### BAKER PLAN

Mr. Secretary, my understanding is that in the last four years or so, American banks have increased their nominal exposure in terms of Latin American debt, but that they have increased their lending by less than the rate of inflation. Your initiative is certainly a welcome one, and I think a welcome change from previous Administrations' hands off approach.

Let me ask you, what kind of cooperation do you really think you are going to be getting from the banks? I ask that in light of a statement by George Clark, Executive Vice President of City Bank, who was testifying on the President's tax reform proposals, and as reported in the Washington Post. He said as follows:

"That a provision in the legislation cutting back on foreign tax credits for taxes on interest earned from international loans could undermine the proposal made by Treasury Secretary James A. Baker to have banks increase their lending to Third World nations by $420 billion. Without the strong support of the U.S. banks the Baker initiative is going no where."

Have you been able to convince the American banks, who would be the major people who get clobbered if things went to hell in a hand basket? Have you been able to convince them that they ought to regard your plan as something other than a lobbying tool to reverse field and allow them to try to leverage something on the tax reform bill?

Secretary BAKER. Well, I think it is understandable that they might bring up not only that provision of the tax reform bill but perhaps some others. But to answer your question directly, Mr. Chairman, we have received written pledges of support from United States banks holding approximately 95 to 96 percent in aggregate principal amount of the international debt outstanding to 15 principal debtors that were the subject of our initiative. So I would have to tell you that while there is some feeling on the part of some of the smaller lenders and some of the more regional institutions to not look for any more cheese but try to find a way out of the trap, we have received extremely good cooperation I think on balance from most United States banks. And we have received similar written pledges, if I may say so, from the private banks of most of the other industrialized countries, I think all of the other major industrialized countries. The provision to which he refers is one that quite frankly, is being looked at in connection with tax reform over in the Senate.

The same argument has been used with respect to the tax reform proposal to deny the ability to budget for loan loss reserves. We have made the point there that these are two completely separate matters and they ought to be considered separately, and in our view they will be considered separately.

If I may make one additional point. We have said from the very beginning that we are not trying to strong arm banks into participating nor are we trying to cajole them through the use of World Bank guarantees or some other programs of assistance. It is our view that the banks troubled loans are not unlike a domestic credit which might get in trouble, can sometimes with assurances of additional flows become a better credit.

We look at that exactly the same way with respect to these international loans. We are not trying to promise anything out of order, and we are not trying to strong arm. We think the banks, particularly the major ones, will participate because they will find it in their self-interest to participate.

### THIRD WORLD DEBT PROBLEM

Mr. Obey. Let me ask you, as you know, you have been urged by a good many people to use the leverage of the banks, the multilateral banks and to use the influence of the United States overall on the resolution of the Third World debt problem, to push countries into following the "supply side model to economic recovery and development". I absolutely grant the desirability of doing that in some regions of the world, primarily Africa, here I think there is no question that those governments have been way too heavy handed in the way they have intruded on the economy.

On the other hand, however, all regions of the world are not alike and if you take a look at Central America, for instance, I think you have precisely the opposite problem there. You would have in my judgment governments which are so weak that they are not able to politically, much less economically, control the actions of some very strong economic elites in some of those societies, and my concern is that if we are to pursue a desirable end in one region of the world, we not be overzealous in pursuing that same prescription in areas where it doesn't fit. Especially when if you take a look at what has happened around the world right now, I really don't really think we have a shortage of supply of much of anything. We have an incredible situation with inadequate demand, whether you are talking about demand for foodstuffs or whether you are talking about demand for computer chips or you name it. There is a tremendous sluggishness on the part of the demand. I would like your response to that.

Secretary Baker. Well, I don't disagree with you with respect to the question of demand of many, many commodities in the world, and for that matter many manufactured products.

I think it is important to note, as we made very clear in Seoul in announcing this initiative, that it is the extension upon our case by case approach to the debt strategy. You have to look at each debtor nation separately and individually, and you have to take into consideration the economic conditions and the economic structures of each nation with respect to which measures will be appropriate and which may not be appropriate.

But generally speaking, I think concentration on free market economic policies could be beneficially emphasized in practically all of the major debtor countries that we enumerated; the 15 countries we talk about.

Mr. Obey. Let me ask, I was reading a good deal the last couple of weeks about what various people have said about your initiative and I have read with great interest the memo by the Heritage Foundation. A lot of points were interesting, not in what they have to say about the Banker Plan. Not only they, but a number of others argue that it is a mistake for us to continue to pretend that all of those Third World loans are good loans and in fact we ought to accept the fact that the American banks are simply going to have to eat a portion of those loans, ten or fifteen percent.

I know Samuelson and a couple of others have suggested, why isn't that accurate?

Mr. OBEY. Well, it may prove to be, it may well prove to be accurate, Mr. Chairman, but basically what they say is let's accept that as a fact now, let's declare defeat now, start writing these loans off to a greater degree than we are now, with whatever impact that has on our United States banking institutions and perhaps even more importantly, with whatever impact that has on some of those fragile democracies in Central American and South America that are so important to the United States from a geopolitical standpoint.

I don't see that as an alternative approach to trying to solve this problem. I see it as a declaration of defeat that the problem is not solvable, and that the only recourse is to accept the fact and write the stuff off. That is the approach they advocate.

Mr. OBEY. What is wrong with the idea of telling banks that they simply ought to accept the 15-percent writedown on those loans?

Secretary BAKER. Well, there is nothing wrong with that if that is the regulators' analysis. Let me say this, if you are saying we should not try to work this problem out and solve it, that we are not going to try and increase support from the multilateral institutions and reform those economies, then maybe we ought to do what you suggest.

Mr. OBEY. I don't think, to be fair to the Heritage Foundation, I don't think they are suggesting we not try to reform those economies.

Secretary BAKER. Who is to say we are going to obtain those reforms if we pull out of the picture and say we are not going to participate with you any more with respect to additional capital, whether it is equity or debt.

Mr. OBEY. So what is your response to Bruce Bartlett's objection to your plan in which he simply states that the problem with the Baker Plan is that it resolves nothing. I am playing the devil's advocate.

Secretary BAKER. Sure.

Mr. OBEY. I don't very often agree with the Heritage Foundation, but his point is essentially that this tries to solve a Third World problem with more debt and that we are just fooling ourselves and fooling them if we try to do that this way.

Secretary BAKER. Well, as our proposal points out, it would be far better to see these capital flows coming in by way of investment and equity rather than debt. We want to do everything we can to encourage the countries to adopt policies that would stimulate further foreign direct investment or additional foreign direct investment.

Mr. OBEY. Mr. Edwards.

Secretary BAKER. I might say one other thing, I think Mr. Bartlett's criticism is to a large degree predicated on the fact that he doesn't believe that the countries will implement the economic reforms, and I must say that that is the key to the whole proposal. If you don't get the economic reforms, fundamental economic reforms, the craft won't fly, nor should it.

Mr. OBEY. Mr. Yates has to leave. He wanted to ask one quick question.

## MIGA

Mr. YATES. I had a couple of questions with respect to a MIGA, is that the International Equivalent of FDIC?

Secretary BAKER. No sir, it is the international equivalent of OPIC.

Mr. YATES. Well, but as I understand it, you are guaranteeing private loans, aren't you?

Secretary BAKER. Well, it insures, yes sir.

Mr. YATES. You are guaranteeing them in the nature of deposits like our FDIC guarantees deposits of those who loan money to domestic banks?

Secretary BAKER. It is different. The FDIC is insuring a collapse of the institution for economic reasons. I think OPIC insures expropriation and political——

Mr. YATES. You and Mr. Obey agreed that you had 15 percent of the loans that are bad now, and I don't know how many of the loans will cause the demise of a particular institution, but one of the big worries that caused you to put a MIGA into existence I guess is the possibility that the loans may——

Secretary BAKER. No sir, Congressman.

Mr. YATES. Why are you putting MIGA into existence?

Secretary BAKER. To stimulate foreign investment, not loans, but investment. We are not putting in place to insure——

Mr. YATES. You are guaranteeing those investments, then are you not, by MIGA?

Secretary BAKER. We are guaranteeing——

Mr. YATES. That the investors won't lose money?

Secretary BAKER. Against certain risks—expropriation, political risk, that sort of thing. It doesn't have anything to do with loans.

Mr. YATES. I see. Well, what is the status of those loans? For a while there, there was a big turmoil between the banks and the debtor countries because of high interest rates. Have the loans been refinanced at lower interest rates? Are the Third World countries in better financial position than they were last year?

Secretary BAKER. Yes sir, I think over all on balance, the debt problem is in better shape today than it was certainly in 1982. Interest rates for one thing are down, and down considerably. The recent cut in the reduction in the prime following the discount rate cut that the United States, Germany and Japan implemented would save Mexico, for instance, something like $500 million in debt service.

I think there has been considerable improvement. Quite frankly, there has been improvement with respect to the balance sheets of the United States banks since this problem first surfaced in '82. They have got more capital than they had then.

### STRATEGIC PETROLEUM RESERVE

Mr. **Yates**. Let's ask about Mexico. In another committee, we have supervision over the funding of the Strategic Petroleum Reserve. The Administration has cut off purchases under the Strategic Petroleum Reserve, and I wonder why it doesn't make sense, if indeed it made sense to buy oil for the reserves at $30 a barrel, why it doesn't make sense to buy it for the reserves at $15 a barrel, knowing that if you buy it from Mexico, or you buy it from Venezuela, you are sustaining their economics?

Secretary **Baker**. It would make great sense if we didn't have the budgetary constraints that we have on us. The point I think the chairman made in his opening statement was that it is going to be very difficult even to see flat funding from the Multilateral Development Banks itself in the context of no additional purchases.

Mr. **Obey**. That is not what I said. What I said is that I didn't see how we could appropriate a dime.

Secretary **Baker**. Okay, it is even worse, you see, Congressman.

Mr. **Yates**. Except I had the impression that the Strategic Petroleum Reserve very much like the strategic metal and minerals reserves to be considered a part of national defense, that in the event you had an embargo such as we had in 1973 and we were strapped for oil for our domestic economy as well as for our Armed Forces, it made sense to build up a strategic petroleum resource.

Secretary **Baker**. I don't think there is any argument about the importance of it from a national security standpoint, but we have put quite a few barrels in the reserves and——

Mr. **Yates**. You haven't met your initial commitment.

Secretary **Baker**. I guess the real answer to your question, why cut it off at this point, it is because of budget constraints.

Mr. **Yates**. You are not cutting off national defense appropriations.

Secretary **Baker**. No, it is a relative weighing of priorities.

Mr. **Yates**. You are asking us to continue assistance to Third World countries. It seems to me where you get a quid pro quo for your aid by buying a product that they have difficulty selling because of falling prices, you are serving a double purpose.

Secretary **Baker**. Without the budget constraints, Congressman, it would make a perfect mix.

Mr. **Yates**. Plus the fact that you have to provide for additional storage facilities in Texas. Aren't you in favor of constructing Big Hill in Texas?

Secretary **Baker**. Whatever is fair.

Mr. **Yates**. Which side of fairness do you fall on?

Okay, thank you, Mr. Chairman.

Mr. **Obey**. Because I called on Mr. Yates first, let me take two Republicans in a row.

Mr. Kemp.

Mr. **Kemp**. Thank you, Mr. Chairman.

Welcome, Jim. I wasn't here for your testimony unfortunately, but I have a pretty good idea I think I know what you are trying to do. I support the effort that you and the Administration are trying to bring about in terms of world economic growth and I think you are to be complimented on the effort that has been made not only in your speech in Seoul, but also at the Plaza Hotel.

There has been some progress the concept itself has been defined but the Baker plan has not. But this plan is something I would like to ask you about but first I wanted to start by complimenting you on the changes that have taken place, and the effort you have made to put an end to the benign neglect of exchange rates and the role of the dollar in international trade. I applaud it and want you to know that I think it is a critical moment for the Administration and the country and the world to move forward with some plan that will get a more stable exchange rate system for the world, as alluded to in the President's State of the Union.

### DEFICIT HYSTERIA

To start, because I was listening to my friend, Sid Yates talking about this question about spending for the Strategic Petroleum Reserve and Mexico, and your answer about budget constraints. Don't you think it is approaching the time in when someone has to stand up and tell the truth that this deficit hysteria is misplayed, that there is a far different picture today than there was when some of these budgets were laid out?

I was noticing the other day that David Stockman's '84 budget projections for the deficit in FY 87 were $320 billion. Now OMB says $180 or $182 billion. CBO, not to let them off the hook, predicted a deficit in 1990 of about $340 billion. Now they are saying the baseline deficit will be closer to $110 billion. They were off by half a trillion dollars at least six months ago in their estimate of what the deficit picture would look like over the next four or five years.

I don't think we need to paint a rosy scenario but I think when interest rates are lower, when growth rates are higher, when unemployment rates are different, when oil prices are lower—that has its problems as well as its pluses—don't you think somebody in the Administration ought to stand up and say hey, wait a minute, let's not savage our security, let's not savage the potential for economic growth in the Third World, let's watch out that we don't make a mistake in this budgeting that will savage some of your ideas to some of the ideas that might come from both sides of the aisle in Congress?

Secretary **BAKER**. Well, Congressman Kemp, I made that speech about three weeks ago, or when I appeared before the Chairman of the Joint Economic Committee, and I know you are not suggesting in any sense that we don't have to deal with this deficit. As my opening remarks indicate, we certainly believe we have to deal with this deficit but the fact of the matter is, the problem is not what a lot of us thought it might be back in November and December of last year. It is not what a lot of people I think tend to suggest that it is even today.

I think we ought not to lose sight of the fact that for the first time in three or four years we have got OMB and CBO right on the same wave length with respect to what the numbers show. I think it is important to take note of the fact that growth is up, that interest rates are down, that oil prices are falling dramatically, and you know we ought to be bound by, and we ought to live with the numbers that we now have and not start talking about changing the numbers. If these trends continue, the numbers should look even better when we get around to mid-session reviews in June or July.

Mr. KEMP. So you think the hysteria is misplaced?

Secretary BAKER. I am basically agreeing with you, yes.

Mr. KEMP. Good.

Secretary BAKER. I think it is important—I know you believe this that we not be interpreted as suggesting somehow that the deficit doesn't matter. It does matter, and I know you feel the same way.

### INTEREST RATES

Mr. KEMP. I agree, but it is also a symptom of a problem and getting this economy to higher levels of employment and output, without inflation, is important. The world economy is operating, in my view, at about a trillion dollars below its potential, and getting our interest rates down is simply the most important thing we can do to help those Third World debtor countries reduce the huge services of the debt that is now absorbing so much of their foreign exchange.

Secretary BAKER. And the Japanese and German rate reduction should help that.

Mr. KEMP. I was pleased to see that. I give you a lot of credit for that. I was glad to see the Fed finally lower the discount rates. As far as I can see, they could do it again. There doesn't seem to me to be any apparent inflation in this economy and that is just not taken from the atmosphere. If you look at commodity prices, at farm values, look at energy prices, wage contracts, for labor unions, look at any thing you want to in the market, there is no incipient stage of inflation in this economy. Quite the contrary.

I am sure this is true in Texas, Oklahoma, Louisiana, farm states, Minnesota, Iowa, Kansas, and my own home state, where there is some very price deflationary measures. I am asking for lower interest rates here. You said one percent drop in the interest rate means what in terms at lower debt payments?

Secretary BAKER. One half of a percent—$500 million.

Mr. KEMP. I agree we should be talking about more loans. However, right now, wouldn't getting our own interest rates down be more important than just building up more debt service in the Third World, particularly in Latin American debtor nations?

Secretary BAKER. I am sorry——

Mr. KEMP. I was saying wouldn't it be more important, rather than putting more loans out, which is building up a higher debt service, wouldn't it be more important to consider more action on the interest rate side, at least in the short term rates, in order to reduce that debt service and allow those countries, particularly Mexico and the Latin debt nations, to use some of their foreign exchange for something——

Secretary BAKER. I think both are important. You can't get there solely on either side of that equation. But sure, to the extent that we can see interest rates ease without any risk of return of inflation, it will be very beneficial to the debt problem.

Mr. **Kemp**. Do you see any inflation out there? Any market index suggest or manifest inflation?

Secretary **Baker**. The unemployment numbers we saw last month were disappointing. For the producer price index the last number we saw there was a minus .7 percent. Commodity prices are pretty well down; so I would be hard pressed to say that we see signs of inflation today. I don't.

Mr. **Kemp**. I don't either. I think there are some manifestations of deflationary pressures.

### BAKER PLAN

Mr. Chairman, I wanted to ask one more, or make a point, and ask you to respond, Mr. Secretary.

You and Clayton Yeutter have talked about your hopes that have been suppressed. You want the dollar to drop to a lower level or ratio with the yen and perhaps a basket of currencies. I don't know, I have heard it said by Yeutter, I have also heard you say it has to come down even more. Wouldn't it be more important rather than talking down the dollar, which forces or encourages people to shift out of dollar assets into yen assets that are the mark assets or other assets, wouldn't it be more important to start talking about the original Baker plan, or Reagan request, which was formulate a plan written in which we could again stabilize our currency as opposed to manipulating or changing our currency for some trade purposes, would it be better to work towards that convergence with trade without losing the terms of account across boundaries?

Secretary **Baker**. The best solution to our trade problem, I think, Congressman, is for us to continue to work to see some of the other major industrialized countries adopt measures that will permit them to grow to a greater degree than they have in the past. That is going to do more to help us from a trade deficit standpoint I think now, than anything we can do.

Another thing that would help us significantly, in my opinion, is to get a handle if we can on this debt problem. We need to trade with LDCs as well. They need to trade with us, we need to trade with them. That is another reason why I think just writing debt off and declaring basic defeat is a non-starter.

Mr. **Kemp**. When is the Baker plan or Reagan plan or Reagan/Baker study going to come forth? When are we going to see something that will reflect itself as an idea for moving the world towards what the President requested?

Secretary **Baker**. I think you are talking about fundamental suggestions for reform of the International Monetary System and what the President asked me to do in the State of the Union was to consider whether or not we ought to have an international conference. That is the sole charge that I was given and I think it would be appropriate to have a response to him by the end of the year.

Mr. **Kemp**. We have to wait until the end of the year?

Secretary **Baker**. I didn't say it wouldn't come earlier.

Mr. **Kemp**. How about the April IMF meeting, are you going to be discussing these things?

Secretary **Baker**. There will be considerable monetary discussion.

Mr. **Kemp**. April in Paris?

Secretary **Baker**. Not in Paris, it is in Washington. There will be considerable discussions at the April IMF meeting and World Bank Development Committee meetings, because we have got two monetary reports before us—G-10 countries and G-24 countries both have monetary systems reports to be considered.

Mr. **Obey**. Mr. Edwards.

Mr. **Edwards**. Thank you, Mr. Chairman.

Jim, welcome. First, I want to tell you that I think you have done a magnificent job of injecting a new breath of creativity at the Treasury. Obviously the problems we have had in dealing with the international financial situation have been very great, and you have put some pretty good new ideas forth, and like Jack, I am eager to see some of the details spelling that out, but I am glad you are taking that approach.

### STATE OPERATED ENTERPRISES

I am concerned about one area I hope you can elaborate on. Some of us have been urging that we use the leverage that we have in this country, to push the world market more in the free enterprise direction, and we have written to you about that and assume in the Multilateral Development Bank replenishment negotiations and general capital increase talks, that there is some move toward reform in congressional lending and increased emphasis on the private sector, and I wonder if you could bring us up to date on that in terms of what progress we are making away from just support of state operated enterprises?

Secretary **Baker**. I think we are making good progress, Congressman. We have voted against, or abstained on some loans since I have been at Treasury, which we felt had too much of a state owned emphasis or parastatal emphasis, because the loans were not being made to the private sector.

The Program for Sustained Growth, our initiative at Seoul, of course, has as its central focus and basis, concentration on free market economic policies and reliance on the private sector. That is the foundation or fundamental keystone if you will, of that proposal.

I think it is fair to say that the Multilateral Development Banks overall—and some are doing a better job than others—are providing significant support to the private sector in a number of the developing countries. So I think we are making good progress. We have better luck with some than others.

### PRIVATE SECTOR EMPHASIS

Mr. **Edwards**. Does your budget request reflect this increased emphasis on the private sector? Are you confident that the request you have given us will help you continue to move in that direction?

Secretary **Baker**. Yes, I think it will. For instance, the budget funds IFC activities, which are designed expressly to encourage private sector development. We are very much supportive of that, Congressman, and we think that is the way in which we should use whatever influence we have to move the Multilateral Development Banks.

Mr. **Edwards**. I applaud the direction of it. I think we have got $35 million for IFC. I would encourage in subsequent years, or the committee in the debates this year, to try to move those numbers a little bit higher or change the mix a little bit more.

Secretary **Baker**. If we are going to have—if I might put a plug in here for our request—if we are going to have that kind of influence we have got to have the wherewithal.

Mr. **Edwards**. Yes, I started to say after I made this comment, it was probably a comment that I wasted breath on, since the chairman has already said there won't be any money at all.

### SOFT VERSUS HARD LOANS

Let me ask you, one of the other things that we have been trying to do, in addition to increasing private enterprise development, is push us further away from soft loans and more toward the hard loan window and in the 82 Multilateral Development Bank assessments which you referred to in your statement, that assessment recommended hardening terms for countries that had been receiving Multilateral Development Bank loans, and reducing U.S. contributions to the soft loan window.

We have again, I think, $750 million for IDA. Without running through it all, it seemed to me in looking at the numbers, that we were talking about still a fairly small portion in terms of movement toward the hard loan window. What progress are you making on that? What do you plan to do to try to move us further and further away from soft loans participation?

Secretary **Baker**. Well, we are going to continue to apply the pressure that we have been applying in the past, Mickey. It is not going to happen overnight, but I think it is fair to say that all of those institutions know of our desire to move to the extent that they can from soft loans to hard loans.

I think we have made some progress. It may not be as much as all of us would have liked, but I think we are marching down the right path.

Mr. **Edwards**. Well, I just encourage you to continue moving us in that way. Unlike what the chairman has projected, I tend to think that there probably will be some funds forthcoming and so I would like to encourage as much of that as possible to go into the private sector development and hard loans rather than soft loans. I am neither chairman nor ranking member, I will relinquish my time to other members.

Mr. **Obey**. Mr. McHugh.

Mr. **McHugh**. Thank you.

Mr. Secretary, welcome.

### FOREIGN AID BUDGET PRIORITIES

Despite the general climate of optimism generated by our friend, Mr. Kemp, I think the sober note struck by the chairman about the Foreign Aid bill is likely to be realistic and that there will be fewer funds available for foreign aid generally, at least until such time as there is a broader compromise on the budget.

In that context, I want to compliment you for the pragmatic approach you have taken with respect to the multilateral institutions.

Some members were not here, but in your opening comments you indicated, for example, that for every dollar we contribute to the multilaterals, we can leverage $60 of lending to these developing countries in which we have an interest and, indeed, 88 percent of the money that is spent goes to countries in which we have a vital interest.

I think that is important. I am very pleased to hear you say that, because it suggests that, if indeed our foreign aid financing is going to be reduced for overall budget considerations, our priorities should include these multilateral institutions for the very reasons that you have outlined.

### ARREARAGES

I have two concerns about the budget request. First, you have made no request to make up the arrearages on which we have fallen behind. Granted, this is a congressional problem, too, in the sense that we did not appropriate the full request in the past and so we have our own responsibility in this regard, but I think in order to meet these arrearages very strong executive branch leadership is required as well as our own response.

My first question, then, addresses what plans you have to make up the arrearage, recognizing that we are going to be under great pressure for budgetary reasons, and that it will be very difficult to get them. Nonetheless, I think the Administration has a responsibility here, as do we. What are your plans?

Secretary **Baker**. Well, Congressman, I agree totally with you that we have to find a way to make up the arrearage, because after all, they do represent international agreements entered into by the United States after close consultation with the Congress. We ought not to get a reputation for not being good to our word in international fora and international transactions.

We are in the process now of discussing with State and OMB how we can best make up these shortfalls. The shortfall from our FY 86 request I think is about $27 million after the Gramm-Rudman hit of March 1st. We are talking about how best to do that. There are a number of ways. One would be a supplemental, another is to wedge it into a later year budget request.

I am not in a position to tell you here today how we might do that. I am aware of the chairman's dislike of supplementals. But let me just say that we agree with you that it needs to be made up because it is a solemn commitment of the United States that we ought not to breach, and we are examining various approaches.

### AID TO AFRICA

Mr. **McHugh**. My second concern relates to a problem which was outlined in a very good article in the Washington Times today, written by Donald May, the headline of which is "U.S. Deficit Cutting May Squeeze Aid to Africa." The article is lengthy and, without objection, I would have it included in the record.

[From the Washington Times, Mar. 13, 1986]

## U.S. DEFICIT CUTTING MAY SQUEEZE AID TO AFRICA

(By Donald H. May)

U.S. bilateral aid for economic development in Africa faces potentially sharp cuts as a result of the political climate generated by the Gramm-Rudman deficit-reduction law.

The possible reduction in aid comes as World Bank officials warn that projected flow of multilateral aid to maintain Africa's economic momentum isn't enough and increased bilateral aid from the United States or other donors is needed.

According to figures prepared within the bank, sub-Sahara Africa will need at least $11 billion a year in low-interest aid from all sources until 1990 to achieve economic growth of 3 percent to 4 percent a year, just over the rate of population growth.

Present and expected aid commitments from all sources so far total only $8.5 billion a year, according to the bank's tally, leaving a projected aid gap of $2.5 billion a year.

Multilateral agencies such as the World Bank, the International Monetary Fund and the African Development Bank together might make up about $1 billion of this shortfall, according to the World Bank's analysis.

(That assumes that negotiations recently begun in Paris among the bank's donor nations result in a $12 billion, three-year replenishment for the International Development Association, the branch of the World Bank that lends to the poorest countries. It also assumes that a substantial portion of $2.7 billion in expected repayments to an IMF trust fund are reprogrammed in the form of new aid to Africa).

By the World Bank's estimate, this would leave $1.5 billion of Africa's annual aid shortfall to be made up by the major bilateral aid donors—either through increased aid or by extending additional debt relief to African governments, which would have much the same effect as more aid.

The bank's estimate takes into account probable amounts of other kinds of financial flows to Africa, such as commercial bank lending, direct investment and short-term capital.

President Reagan has asked Congress for an 8 percent increase in combined economic and military aid to the world as a whole for fiscal year 1987, compared to the current fiscal year 1986.

But key members of Congress, including some who have supported foreign aid increases in the past, say there is no possibility Congress will approve an overall foreign aid increase while cutting domestic programs in order to meet Gramm-Rudman deficit-reduction goals.

The Gramm-Rudman law already has taken a 4.3 percent bite out of fiscal 1986 foreign aid, as it did for programs across the board.

Absent defense cuts or tax increases, both of which the administration opposes, the law would require cuts of about 20 percent in non-defense programs during fiscal 1987.

Rep. David R. Obey, Wisconsin Democrat and chairman of the House Appropriations subcommittee on foreign operations, which deals with foreign aid, told Secretary of State George Shultz at a hearing March 4: "Mr. Secretary, I can't pass a foreign aid bill on the House floor . . . so long as the members of the House see that we're increasing foreign aid and we're paying for that increase by gutting cancer research, gutting educational opportunity and things of that nature."

Unless there were an overall budget compromise, Mr. Obey told Mr. Shultz, his panel would recommend cutting the total foreign aid program roughly in half, providing $5.4 billion for Israel, Egypt and Jordan, plus $1 billion in military and $1 billion in economic aid for the rest of the world.

According to a congressional staffer familiar with aid issues, that would mean that after countries where the United States has special interests such as base rights, were taken care of, there would be very little left for economic aid to low income countries in Africa and other parts of the world.

The House Foreign Affairs Committee recently recommended to the House Budget Committee an overall fiscal 1987 aid program $2.4 billion under the president's request and $900 million under the level of the current fiscal year.

Foreign Affairs Committee chairman Dante Fascell, Florida Democrat, said the foreign aid program will be lucky if it gets even that amount. "We will have done quite well with respect to the U.S. foreign assistance program if we can hold it at the level which the Foreign Affairs Committee has indicated," he said.

Africa would be particularly vulnerable to cuts in the overall foreign aid budget if a practice known as "earmarking" is continued this year. In last year's foreign aid bill, Congress earmarked and money for Israel, Egypt, Pakistan, Portugal, Uruguay, the Philippines, Greece, Turkey and Cyprus.

Since Congress at the same time cut the total foreign aid budget, this meant the cut fell more heavily on Africa and Central America. No one lobbied to earmark money for Africa.

Some congressional aides have suggested that this year Congress should either earmark aid funds for all countries receiving aid or for none of them.

Another reason Africa is particularly vulnerable to cuts in the aid totals is that about half of what amounts to U.S. economic aid to that continent is contained in an account called the Economic Support Fund.

This fund is designed for countries around the world in which the United States considers that it has a particular security or political interest. In Africa it is used as a highly flexible form of development assistance. It is the aid category most often used by the United States to encourage economic policy reforms in African countries. In that respect it is similar to aid being given by the World Bank to encourage policy change.

But because it is the same fund used to provide budget support for particularly more important countries such as Israel, Egypt and Jordan, it is vulnerable when the entire aid budget is being squeezed.

Officials of the U.S. Agency for International Development argue that economic aid is particularly important in Africa just at this time because a large number of countries there have begun making economic reforms designed to improve their economic development.

These include raising farm prices to provide more incentive to grow food, even though this may raise food prices for urban consumers. In many countries they have included removing price controls or industrial goods, reduicng government bureaucracies and decreasing the role of the state in the economy.

According to U.S. aid and World Bank officials, those changes involve immediate hardships for some residents of these countries—often urban consumers and government workers who lose their jobs. But the benefits in the form of improved economic development will take time to realize.

Mr. McHUGH. Basically, it says that even if we assume that there is an IDA replenishment of $12 billion, based on World Bank estimates there is likely to be a shortfall of necessary resources going to Africa of between $2 and $4 billion. Given the interest the United States has in promoting development and growth in Africa, given what might be a shortfall of resources flowing there from all sources for this purpose, and given the usefulness and leverage which we have obtained through multilaterals, why has not the Administration requested the second installment on the IDA Special Facility for Sub-Saharan Africa?

Secretary BAKER. As you know quite well, Congressman, since it was your initiative, that was a congressional initiative, not an Administration initiative. We feel that support for IDA versus a separate budgetary request for the Special Facility really serves our long term interests better. We do have a trust fund reflow proposal, as you are aware, that we support as far as IMF trust fund reflows are concerned, and we are making every effort to combine that with some additional World Bank funding to come up with a bigger package.

We tried to sell that to the G-5 in Seoul and we were unsuccessful. We have since made some progress and that proposal is now being considered by both IMF and the World Bank. We are very conscious and concerned about the problem. We think, frankly, that the trust fund approach and the IDA approach are better approaches to the problem than the special facility approach.

Mr. **McHugh**. I hope you will remain flexible and do what is fair on that, Mr. Secretary. This was not only a congressional initiative, of course, it was initialed by many of our friends and allies.

Secretary **Baker**. Right.

Mr. **McHugh**. Who share our common interest in development in the Third World and in Africa in particular.

Secretary **Baker**. I think it is important for the record to reflect that last year I think our total bilateral aid to Africa was almost in the $2 billion range.

Mr. **McHugh**. We support the bilateral efforts as well.

### WORLD BANK LOAN MIX

Mr. Secretary, I would like to ask you about the appropriate mix in the World Bank, between development project loans on the one hand and structural adjustment loans on the other. What is the current mix of those funds?

Secretary **Baker**. You mean expressed in percentages?

Mr. **McHugh**. Yes, or dollars, or whatever you can give us.

Secretary **Baker**. I totaled it. Seventy-five percent project and 20 or 30 percent non-project. We have been anxious to increase that latter percentage.

Mr. **McHugh**. What would you like to increase it to? What do you think the appropriate mix should be?

Secretary **Baker**. I am not sure we have a specific target, but for instance, our program for sustained growth calls for additional structure adjustment lending, sectoral adjustment lending, longer term loans that could support fundamental economic reforms in these countries. I don't think we have given the bank any sort of a percentage. We are just trying to move them toward an expansion toward that category.

Mr. **McHugh**. I agree with the goal of promoting those fundamental economic goals. I think that is an issue upon which most of us here would agree.

My question then would be, do you see this increase in structural adjustment loans as a permanent change in World Bank lending policies or is it something which you think is particularly appropriate for this particular time, given the debt problems and the need for economic change?

Secretary **Baker**. Well, I think it is particularly appropriate for this particular time. But further than that, I think the bank is particularly well equipped to lend some of its resources and some of its time, talent and attention to those kinds of loans, and I think we would have a better world economic system if the bank were willing to do that. Now, there is a point beyond which obviously you wouldn't want to go because development lending is important in and of itself, but the focus has been too much on that I think.

### ASSISTANCE TO POOREST OF POOR

Mr. **McHugh**. One of the criticisms or concerns expressed by some people is that the traditional approach of development project lending is not only more visible, you can point to it and, therefore, continue to generate support for the World Bank funding, but that it can be seen to be directed more towards the poorest of the poor people, particularly to the extent that it is tied up in things like development projects.

Secretary **Baker**. But a proposal conceived and implemented, a structural adjustment loan, might well do more to help the poorest of the poor than four or five developmental projects.

Mr. **McHugh**. I know the argument is that if we have real economic growth on a permanent long-term basis everybody is going to benefit, including the poorest of the poor. I don't necessarily disagree with that, but I think it would be helpful, to the extent that you and others in the Administration can, to demonstrate that there is a sensitivity to the poorest of the poor benefitting, because again, those development project loans are more visible signs of direction toward the poor, whereas, the structural adjustment loans are less visible in terms of something that can be seen on the ground. While over a long period of time, economic growth may indeed benefit the poorest of the poor, I think a lot of the political support, at least from some quarters, that has been generated for these institutions is premised on the proposition that the poorest of the poor are being helped. The extent to which we move more and more toward structural adjustment loans, at least in the short term, the less one can point to the visible results.

Secretary **Baker**. I understand what you are saying.

Mr. **McHugh**. It is a political as much as an economic question.

Secretary **Baker**. I understand.

Mr. **Obey**. Mr. Mrazek.

### RENEGOTIATION OF SOFT LOANS

Mr. **Mrazek**. Mr. Secretary, I am curious, we have a number of IDA loans that have gone to relatively well off countries. At the present time, for example, Korea I think owes $107 million. Their economy is in reasonably good condition right now. Jordan is doing quite well. It owes $82 million to IDA. Turkey owes $178 million. I am wondering if it is feasible, in your view, to have the IBRD at somewhat higher interest rates—re-lend in essence that money to those nations, thus freeing up IDA credits for those less developed countries that you indicated in your testimony obviously are in far greater need for IDA loans? Do you think that type of proposal would be feasible?

Secretary **Baker**. Yes sir, I do. Well, I think it would be. It is a good proposal. I think it would be very beneficial and it is something I believe that we have had some discussions with the bank about, that is putting some sort of a provision in future IDA loans that would permit a renegotiation if the country in effect grew out of eligibility. I think it is a very worthwhile thing to do.

Mr. **Mrazek**. What could we do with those nations that are now better off? There is of course not a component built in their loan contract, but is it possible to encourage a nation Like Korea to perhaps consider going to an IBRD loan? Is there some way the Administration can play a role in that?

Secretary **Baker**. Well, you are talking about loans that have already been negotiated, funded and are in the books. Are you suggesting we do this on a bilateral basis. If you did it with Korea, wouldn't you have to do it, wouldn't there be some obligation——

Mr. **Mrazek**. Perhaps we could develop a set of criteria for those nations that would no longer put them into the category of less developed countries and which, a lot of the assistance that we have generated to LDCs, bilaterally as well through the IDA, have allowed countries to grow economically to a point where they wouldn't be perceived any longer as the type of nation that would require these types of loans, and perhaps, in the interest of cooperation with the United States, these nations would consider allowing some IDA monies to be freed up for nations that obviously are hurting.

Secretary **Baker**. I think it would probably be more appropriate for discussions or negotiations to come from the bank, but if those were to fail, provided you didn't do it on an exclusive basis, perhaps there could be some consideration given to taking a look at that approach. That is something obviously that wouldn't be a Treasury call.

Mr. **Mrazek**. I understand that. Perhaps we will look into that from this side.

## MIGA

I am wondering, the World Bank now has a new agency within it, as I understand it, called the Multilateral Investment Guarantee Agency, a new affiliate to the World Bank, and it is my understanding that it is being assigned the role which basically guarantees investment against terrorism or problems within a less developed nation. Needless to say, that is fairly close to what OPIC presently does, and most of the other nations seem to have something like our Overseas Private Investment Corporation, which protects foreign investment—most of the other donor countries at least. Yet, in the '87 budget the Administration proposed that OPIC be privatized and I am wondering why we are creating a new international agency, when in fact all of the donor countries, or most of them, have an agency in place that could accomplish this same purpose.

Secretary **Baker**. Well, because the MIGA is a multilateral institution, as you pointed out, with development country membership, they are going to be more persuasive, it seems to me, with the developing countries in terms of reforming their laws and respecting foreign direct investment than our OPIC would be; or than the private sector equivalent of our OPIC would be.

Mr. **Mrazek**. If OPIC is privatized basically, private investors in this country who would be looking to invest overseas would be going for their own private insurance.

Secretary **Baker**. Yes, they would seek to purchase the same kind of insurance that OPIC furnishes, expropriations and political risk insurance from a private insurance carrier.

To some degree, they might find some coverage through MIGA. It is possible they would be eligible.

Mr. **Mrazek**. All right.

As I understand it, there are at least some reports that IDA will be in the range of around $12 billion, that our contribution would be in the neighborhood of a billion dollars annually. Do you think this is realistic, considering our current budget problems?

Secretary **Baker**. Well, I think that is on the high side when you say $12 billion. What we have indicated is a willingness to talk in the range of $9 to $12 billion, and a lot of what we will ultimately recommend will depend on the extent to which we are able to achieve reforms we are seeking.

Mr. **Mrazek**. That is the range?

Secretary **Baker**. This is just a negotiating range as far as we are concerned, and we are not up here at this time asking for a $12 billion figure.

Mr. **Mrazek**. I understand. Thank you.

Mr. **Obey**. Mr. Secretary, it looks like we are going to have a string of votes over there, so this may get fairly chaotic. We may decide to shut it down unless somebody changes their mind over there. But until that happens, let me just ask a few other questions.

### BAKER PLAN

Mr. **Obey**. I guess—I don't want you to take this as criticism of your initiatives because I think the initiative is certainly welcome—but I can recall the heat that a lot of us took on this side of the table the last time we had international monetary problems, and we wound up supporting the IMF request of the Administration and a lot of us got chewed up for doing that by members of the President's own party, who were running the Republican Congressional Campaign Committee. They used our votes in support of the President's request on the IMF and tried to shoot us with those same votes, which I found to be an interesting way to play the game.

But my question is, this time we have at least a risk that we are facing the same kind of situation. Mexico is in a lot of trouble, so are some other countries in Latin America, and I know just as sure as anything that people are going to begin to attack your plan as being a way to simply deal with the problems of the commercial banks.

Let me ask you, again pursuing the line that I was pursuing before, you indicate you have some firm commitments from the banks, but they have not been anxious to resume lending in that part of the world. My understanding is that the lending that they are doing is at interest rates that are still 130 basis points above the London rates. Are we really going to get the banks to do their fair share to deal with the problem which they—I don't say they have sole responsibility for the problem, you had an interest rate problem, you had the oil crunch problem—but you also had the banks looking madly for anybody who would take their loans at one point. They walked into it, why shouldn't they be asked to do more?

Secretary **Baker**. Mr. Chairman, let's don't lose sight of the fact we are not up here asking for any money for implementation of our initiatives.

Mr. **Obey**. I understand.

Secretary **Baker**. So anybody who criticizes it as a taxpayer bailout of the banks or debtor countries is flat off base.

Mr. OBEY. You are asking the international banks to in essence move in and take over a larger share of managing the problem. You are asking the World Bank to move in and do more——

Secretary BAKER. Within the constraints of current financing.

Mr. OBEY. I understand. They are still being asked to borrow more by changing their accounting practices.

Secretary BAKER. Well, let me get to the principal question you asked. Yes, I think that the banks will participate because they will conclude that it is in their best interests to do so. They will follow through on their written expressions of interest. But they won't do it unless, and in my view they shouldn't do it, unless the debtor countries are willing to fulfill their share of the bargain and implement the kind of economic reforms that are going to be necessary if they are ever going to earn their way out.

Mr. OBEY. Can we get into that? Let me hold this question, since he hasn't had his turn, let him proceed.

Mr. LEWIS. Good morning.

Secretary BAKER. Hi, Jerry.

Mr. LEWIS. Mr. Secretary, I have already shared with your personally my own appreciation for the line, the direction that Treasury is taking relative to the very real need we have to assist in pressuring our friends in multilaterals like the World Bank, to see that the money that we contribute is delivered in the fashion that best meets our interests in stimulating good economic policies among the Third World. I must say that the proposals you have put forth very much reflect what is the best interest of the United States, as well as the best interests of those people who respond in a fashion that leads to meaningful policy changes.

### IMF MEMBERSHIP FOR POLAND

I am concerned about a number of things. I would like to first ask you to respond for the record if you would, relative to what our position is and will be relative to Poland, which is currently being considered for membership in the IMF. I ask this question as kind of a starting place since your policies have so strongly indicated our desire to have our contributions assist in changing the economies of the countries we would see assisted. I frankly doubt that anything that we might do is going to do much with the economic policies in Poland. I would strongly urge the Administration to continue its hold on their application. What is going to be the position of Treasury?

Secretary BAKER. Well, as you know, Congressman—first let me say this, that in talking about economic reforms you are really talking about reforms with respect to the debtor nations that are listed. Poland, of course, is not one of those.

Mr. LEWIS. As she goes into membership you know that as well as anybody else that is my concern.

Secretary BAKER. That is right. Sure I understand that, I wanted to make the distinction between them. As you know, the President agreed to lift his objection to the IMF processing Polish membership once the amnesty that the Polish Government announced had been completely and reasonably implemented. Now, I suppose one could argue that there are benefits to be derived from the membership of Poland in those institutions, as well as perhaps some detriment. The benefits are that we would be in a better position to exercise some influence and to have some say, as you have indicated, even perhaps in their fundamental economic measures.

So I don't think it is a black and white situation, Congressman, I think that some things that would argue in favor and some things that might argue against it. Its eligibility to become a borrower, of course, is something that we are very interested in, and its eligibility will be computed with respect to its per capita GNP. As you well know, we had some major problems about that computation as far as Hungary was concerned. We have expressed our reservations to the IMF.

Mr. LEWIS. Not an unreasonable concern.

Secretary BAKER. Not an unreasonable concern at all. And we will have the same concerns with respect to Poland. We will want to make sure those computations are accurate.

Mr. LEWIS. We haven't been so successful making sure the computations in Hungary were accurate?

Secretary BAKER. That is correct.

### ETHIOPIA

Mr. LEWIS. So we probably will face the same difficulty again.

Shifting briefly, we are talking about bilateral assistance, we had a good deal of bilateral assistance, as indicated to African countries. Can you tell me, moving to multilateral consideration in connection with some of those African countries, is it true that the World Bank has just sent an appraisal team to Ethiopia to help finance that government's resettlement program, a program which you know has been denounced by many observers as a cause of widespread death and starvation and that should be of concern to the American Government?

Secretary BAKER. No, it is not true, Congressman. A team has been sent, as I understand it, to discuss a possible agricultural loan, but not to talk in any degree or extent about financing the resettlement program that the Government of Ethiopia has begun to implement.

Mr. LEWIS. I would appreciate it if you would follow up on that question, for our sources would indicate that indeed no small part of the purpose is to lay the foundation for helping finance that government's resettlement plans. I would think our voice ought to be heard in this connection.

Secretary BAKER. I quite agree with you and I believe we have already made our voice heard in that connection, and the answer we got back was that it was not to finance a resettlement program. We would frown on that very strongly.

### SOFT LOAN LENDING

Mr. LEWIS. Congressman Edwards earlier was probing a bit—I am not sure, maybe I missed the response and maybe it is that you couldn't give one—in discussing soft loan lending, it is very clear that Treasury's review of soft loan lending patterns would suggest that our purposes would be better served if we moved toward those hard loan windows. In the recent past, an illustration of our own attitude and policy ease the clear movement when we reduced replenishment in IDA-7, there is evidence that Treasury is now reversing the policy on concessional lending. Is that so, and if it is, can you give me some detailed justification now for the record?

Secretary **Baker**. The 1982 assessment that you are referring to, Congressman, did recommend cutting the Multilateral Development Bank and particularly the concessional windows. I think in response to that report and study we succeeded in reducing lending through those concessional windows, and to some degree in slowing the growth of the Multilateral Development Banks. But that assessment also recommended that we support the Multilateral Development Banks, and that we seek improvement in their performance.

As I indicated to Congressman Edwards, these institutions have made some improvements at our urging. There is still some more room for improvements as I further indicated. We are going to keep pushing for further reforms and for further improvement but the fact of the matter is we do look to those institutions to play a central role in furtherance of our international economic and political interests. But we are not backing off from that study one bit. We think we have made some progress since 1982.

Mr. **Lewis**. One of my serious concerns is that when you take the soft loan window and deliver let's say a 50 year loan at very low interest rates to a country whose government would indicate that their economic changes would be going in the direction just the opposite of what we would encourage, rather than in the direction we normally would espouse. The control mechanism you have over those long term zero interest or very soft loan sources is difficult at best. I don't know if we have overcome the lack of policy impact we had in India when we started making long term loans to China, for example.

Secretary **Baker**. We don't have a veto and of course if we had one, we would be able to implement whatever we wanted but we wouldn't get the $60 to $1 bang for the buck we now get. However, I think we can continue to keep up the pressure and we can continue to vote against loans of that nature. We have been successful in decreasing the share or the access to the soft loan window of some of the countries such as you mentioned.

Mr. **Lewis**. I have a number of other questions I wish you would refer to and help us with, for the record.

Secretary **Baker**. Be glad to.

### PRIVATE SECTOR DEVELOPMENT

Mr. **Lewis**. Mr. Secretary, I am interested in one other item specifically. Your emphasis upon having our capital flows and our support to encourage private sector development, moving away from state owned enterprises, is very encouraging to me. The platform rhetoric is important but, adding teeth to that dialogue can be much more difficult. It would appear that a percentage, as a percentage of World Bank lending for state owned enterprises has increased since we took that trip to Korea together, rather than decrease. The record would indicate that is so. Do you believe it is so?

Is there going to be a reversal of that pattern? If so, what evidence is there this is a reversal?

Secretary **Baker**. I am not sure there is a fair period to measure by. I can't answer that question because I haven't seen any numbers from the time we were in Seoul until now with respect to World Bank lending to parastats versus private sector.

I think from the period 1982 to date, that the numbers would show that private sector lending has increased and state entity lending has decreased by the World Bank.

Mr. **Lewis**. I am specifically concerned about Brazil and loans to the state owned power sector, the state owned development banks—the Northeast Rural Development project, et cetera—and evidence of a continuing pattern that says the World Bank thinks the dollars are best used when going to government owned institutions versus the private sector.

Secretary **Baker**. Well, I share that concern, Jerry, and I think that we want to continue to work toward greater participation by the private sector, more loans to the private sector, fewer loans to the state owned entities.

I think we ought to take note of the fact that Brazil has recently embarked upon a program of selling shares in its state owned oil and gas monopoly to private citizens. They are not selling a majority interest, but nevertheless it is a clear step in the right direction in terms of expansion of the private sector. So there are some things that are going in the right direction.

I will be happy to have the staff run the numbers, both 1982 to date and Seoul to date, and we will take a look at them. We really have the same objective, believe me, that you support.

### EQUITY INVESTMENT

Mr. **Lewis**. Mr. Chairman, you have been more than kind. If I could make one comment on this point—Secretary Baker placed in the center of his presentation in Seoul an item that is I think most important—a great emphasis is placed upon equity investment consideration on the part of those developing countries, suggesting essentially that if Mexico would allow other parties to put their capital into their potential growth, that their debt problem could be greatly diminished. The Baja, California enterprise, that voice at least is very significant. Any progress that is made and continuing the pressure of your good offices, I think is appreciated, and commended, but very important as we see that change in the pattern in the developing world.

We appreciate the work you have done and my questions may seem critical, but we are interested.

Secretary **Baker**. Thank you.

Let me say on the last point, one reason we are asking for this MIGA is because it is going to help promote foreign direction investment.

Mr. **Lewis**. Thank you.

### STRUCTURAL REFORM

Mr. **Obey**. Mr. Secretary, getting back to the exchange you and I were having, we started to talk about structural reforms, if necessary, on the part of recipient countries. I certainly agree with that but I am concerned we have been told domestically for a lot of years now, that for instance on an environmental cleanup, things like air pollution, we shouldn't worry so much about how people reach certain standards. We should tell them to reach them and if they get there through their own way or through somebody else's way, it is fine as long as they get there.

It seems to me that the key issue in a developing country is whether they get their prices and investments situation straight rather than how they get those matters straight.

I have got two fellows who play the guitar in my Blue Grass Band. One of them took lessons for years and one learned on his own. Together they make a hell of a good song. They didn't get there the same way.

My concern is that in our belief that these countries ought to reform the way they do business, I am concerned that we not get into the business of micromanaging their economies rather than simply giving them specific general guidelines how they get there, that is my concern. I don't want to see us get into the business of telling this country you have to sell that, you have to privatize that sector, or another country that they have to sell off.

Secretary **Baker**. I couldn't agree more. We will not be successful if that is the approach we follow. It has got to be their plan, it has got to their initiative. One of the reasons, quite frankly, that you see some of the comments, such as you mentioned here earlier, about how far and how fast our proposal is being implemented is because none of these countries wants to be told by Uncle Whiskers what to do. As a domestic political matter, they simply cannot be seen to be taking suggestions, orders, or demands from the United States. I happen to believe a lot is going on with respect to some of these countries that won't be publicized, has not been publicly acknowledged and won't be publicly acknowledged. Steps are being taken. But I couldn't agree with you more that we can't get into that business.

### BAKER PLAN

Mr. **Obey**. Mr. Secretary, I think a lot of people believe very fairly that your plan probably represents a good, long term prescription for getting at the problem, getting at the root of the problem, but we have got some short term problems which stand in the way of our getting to the long term.

The supply side prescriptions by definition, are long term strengthening devices, they don't necessarily provide short term increases in the demand that are necessary. In that regard, I want to come back to my question to you about the banks. As I understand your plan, you are asking banks to cough up an additional $12 billion, about $4 billion a year. In comparison, it is my understanding the Latin debt is about $36 billion overall. Latin American interest alone is about $40 billion a year, as I understand it. To me, that indicates a pretty small request that is being asked of the banks and especially when the banks, unless somebody has changed recently, are still lending at very high interest rates. As I indicated earlier, 130 basis point above London. What I am trying to figure out is why shouldn't the banks be asked to do more? Why shouldn't they be asked to bring their interest rates down? Is it not more realistic to expect that those interest repayment demands be eased through an adjustment on interest rates?

Secretary **Baker**. Mr. Chairman, the figure is $20 billion. You mentioned $12 billion. But just so the record reflects the fact it is $20 billion that we are talking about over three years from the banks or 2.5 percent roughly of their current exposure to these 15 debtor nations. The interest figure or the total outstanding debt includes all Latin American countries, not just the ones that are in the——

Mr. **Obey**. I understand that.

Secretary **Baker** [continuing]. In the proposal.

As far as interest rates are concerned, interest rates have come down considerably over the past both long and short term over the past two years, so the interest burden is not going to be what it was, as indicated earlier, back in '82—but let me finish. Also the banks have been reducing their spread. They reduced their spreads in the last go-around with Mexico considerably. They have just renegotiated—Brazil has reached an accommodation with its bank advisory group to roll over some of its debt at reduced spreads. Those spreads are coming down.

More importantly, I think interest rates generally are coming down. I realize some people have said this isn't enough, and frankly, some debtor nations would like it if we put $250 billion on the table, but this is manageable.

In our best judgment—the Treasury, the State Department, and the Federal Reserve—it is sufficient with respect to those 15 countries.

Mr. **Obey**. It may be manageable in the long term. My point is that you have got a crisis that is going to occur in the short term, but you also have got—it seems to me, if our goal is to make the ability of those economies to grow so they not only deal with their own economic problems but they also are able to increase their trade with us, to relieve our own deficit payment problems—after all, we have a bigger thing in terms of trade with Latin America than we have with the Japanese, the last few years. It seems to me that—what I am trying to figure out, as I understand it—it is in the interest of the banks to go along with your plan. What I don't understand is why they shouldn't be told to do more, because after all, if you don't do anything, where in God's name are they going to go?

Secretary **Baker**. Mr. Chairman, we are not telling anyone to do this. We are suggesting that they will find out in their self-interest to do so when measured against these countries taking the appropriate reform steps. You could funnel $500 billion into those countries and it would just leave via capital flight if you didn't get the countries to implement the kind of reforms that are necessary.

Mr. **Obey**. You are raising reforms. I am not arguing with you on reforms, I am asking you—I am not talking whether the other countries ought to do it. Let's stipulate they ought to do it. It seems to me the banks ought to be asked to do more, also.

Secretary **Baker**. If the other countries do the reform it is my view the commercial banks will find it is in their self-interest to come up with this additional money. Who knows, maybe they will come up with more, but we are not twisting arms and we are not bailing out.

Mr. **Obey**. Let me ask a couple of questions you raised. I have got a series of questions for the record which I would like to put in.

Secretary **Baker**. Yes sir.

### ENVIRONMENTAL CONCERNS

Mr. **Obey**. But let me—you mentioned environmental concerns that the committee had raised last year. Just again, I have four or five questions I want to submit for the record, but two I will ask you here.

Do we have much evidence that the overall quality of the multilateral development bank environmental analysis is improving? Do we have any indication that the banks have gotten the message or are paying anything more than lip service to the concerns about long term destruction of the environment in some of their developmental projects?

Let me cite a number before you respond. The Indonesia Transmigration program, which as I understand it is a huge tropical forest operation for which a fifth loan was approved for $180 million in May of '85. Two loans approved in November of '85 totaling $450 million for the first stage of the Indian Armada River irrigation scheme. Given the fact that the banks' own projected economic return for these loans appears to be lower than average, in light of their substantial environmental impact, my concern is are the banks really getting the message?

Secretary **Baker**. I think they are beginning to get the message, Mr. Chairman. A lot more needs to be done, and as you know, we have got to report to you by 31 March in detail with respect to the steps that are being taken. I think that there has been fairly positive movement in several assessments on the part of some of the multilateral institutions. I think the World Bank is alert to the problem and systematically examining how natural resources might be used in preparing projects.

The Inter-American Development Bank has recently implemented a systematic approach to identifying projects that they would consider environmentally sensitive, and the Asian Development Bank is taking some steps. We have still got a ways to go, however.

Mr. **Obey**. Could you expand on that latter point, that was my second question. I know that you are talking about an early warning system, to alert people before you get committed to large amounts of resources to something in the neighborhood of—how is that system going to work?

Secretary **Baker**. Well, what we are doing is sending cables to our embassies and AID missions before there is an evaluation of the projects. That is just one of the tools we are using. We are alerting them out in the field when one of those projects is up for consideration.

Mr. **Obey**. Nothing more concrete than that in some of the regions that are most subject to criticism?

Secretary **Baker**. Well, I have already mentioned what the banks themselves are beginning to do in terms of self-assessments. We are also trying to monitor the problem through our AID——

Mr. **Obey**. My understanding is that the banks are structured in such a way that the resources which they devote to even considering environmental implications, some of their operations are spread so thinly you can't rely on them to do at lot unless they know that we are going to be squeezing their toes.

Secretary **Baker**. That is true. We have let them know we are going to be examining this issue and how important it is to us, and I really believe they are beginning to get the message. As I indicated in the first part of my answer there is still a ways to go.

### MEXICO

Mr. **Obey**. Mr. Secretary, we are going to run out of time. Let me put a number of questions in the record and ask you one last question on Mexico.

What can we expect to see there—in Mexico—since we are talking about short term problems?

Secretary **Baker**. Well, we have had a number of discussions with the Finance Minister and Central Bank Governor over the course of the past two weeks. It is our view that from an external accounts standpoint, the situation is clearly manageable within the ordered processes given an oil price of $15 per barrel. The Mexican Government is going to be talking with their bank advisory group and the IMF. They have discussions ongoing right now with the World Bank, and they are seeking to resolve the problem through the usual and customary means.

Mr. **Obey**. Let me put the rest of the questions in the record.

[Questions and answers for the record follow:]

## Questions and Answers for the Record

### Early Warning System—Botswana

Mr. **Obey**. Last December, the World Bank signed a loan agreement for more than $10 million for a project designed to increase beef production in Botswana. The Turner Broadcasting System is airing a film this month which makes a compelling case that Botswana is already experiencing severe environmental degradation because of overgrazing of non-domestic cattle.

Some claim that this project, like two previous ones there, will be both environmentally destructive and economically disastrous.

In a report entitled Operation and Viability of the Second Livestock Development Project (1947-BT) Selected Issues, the Bank's own consultants said that while the goals of the Botswana government are to "stop overgrazing and degradation of the veld; to promote greater equality of incomes in rural areas; and to allow growth and commercialization of the livestock industry on a sustained basis" that "the project deficiencies involve a reversal rather than an effective implementation of these aims."

Mr. Secretary, I understand that a result of very recent criticisms along these lines in many different sectors, the Treasury Department has begun to look into the Botswana situation.

As we discussed earlier, Mr. Secretary, the Treasury Department in conjunction with the Agency for International Development, has an "early warning system" to flag environmentally sensitive projects before they are approved by the banks.

Would you elaborate on how you envision AID missions being used to supply detailed information in a systematic way to ensure informed review of environmentally sensitive multilateral development bank projects?

Secretary **Baker**. Approximately one to two years before a project is presented to the Boards of the banks for approval, U.S. agencies receive the first indication that the project is planned. At this time, U.S. posts abroad are asked whether they are aware of any particular problems with the project. All Inter-American and Asian Development Bank projects and most African Development Bank and World projects are covered.

If the U.S. post abroad has an AID mission active in the same sector, reasonably specific information based on conversations with visiting bank missions and borrowing government officials can be provided. If there is not AID mission or if the mission is not active in the project sector, information will usually be far sketchier and may be forthcoming only if the development activity has attained some notoriety. In short, posts are queried for information on hand, although some responses suggest the systematic canvassing of knowledgable contacts.

It should be understood that the primary purpose of this phase of the "early warning system" is (a) to identify and to resolve any possible conflicts between U.S. bilateral assistance activities and proposed activities of the multilateral agencies and (b) to provide a preliminary judgement on the priority and soundness of the project. The system only began to focus specifically on environmental aspects of projects in June 1985.

Approximately two to six weeks before Board consideration of a project, a second cable is sent to U.S. posts, usually containing a brief project description and, again, soliciting post views on any possible problems. All World Bank and Inter-American and Asian Development Bank projects and selected African Development Bank projects are covered.

In this phase, the primary purpose of the "early warning system" is to provide U.S. agencies asnd the U.S. Director in the bank with the most up-to-date advice regarding the project in preparation for Board consideration.

Mr. **Obey**. Was the "Livestock III" Botswana project flagged by the "early warning system?" If not, why not?

Secretary **Baker**. The IBRD "National Land Management and Livestock Project," which is sometimes referred to as "Livestock III," was approved by the Board of Directors in June 1985.

The standard cable inquiries were transmitted. In September 1984, the U.S. Embassy in Gaborone submitted extensive comments on the issues related to the project in response to the first cable. The Embassy reaffirmed its earlier views in the response to the second cable in March 1985.

The Embassy comments were examined extensively after the project documents were distributed for Executive Board consideration. At that time, AID technical specialists and Treasury project review staff reviewed the project in light of the concerns raised in the cable and concluded that the concerns had been sufficiently addressed so that the United States could support the project.

Mr. **Obey**. What is the Treasury Department's current view of the Botswana project's economic viability and potential for environmental harm?

Secretary **Baker**. The direct environmental harm from the livestock industry in Botswana—that is, the extensive range degradation and the threat of desertification from overgrazing—is precisely what the project is designed to address. The underlying principle of the Bank's strategy in Botswana's livestock sector is that herdsmen will find it in their self-interest to maintain a balance between rangeland and herd size if they perceive an economic stake in the condition of the rangeland. The Bank's strategy has been to encourage the formation of private commercial ranches either on the basis of individual ranchers or on the basis of small communal groups of herdsmen.

Specifically, the current project provides financial support for the professional staffing of District Planning Units which are to initiate land use proposals that may become the bases for long-term leaseholds. These proposals are to be acted upon by existing Land Boards that have the legal authority to establish use rights in specified land areas for ranches or for other purposes. The authority of these Boards, which are functioning parts of Botswana's pluralistic and democratic system of government, covers entire Districts, and is constrained only if the central government has legally reserved lands for other uses, such as wildlife protection or national parks. The project also provides funds to be on-lent to ranchers who have viable plans to establish ranches.

That is the basic project design. Successful implementation will not be easy.

The herd expansion of recent decades has taken place in the context of a traditional land use system that perceived rangeland as freely available to all who were prepared to work upon it. The result has been herd expansion in years of fair rains when range grasses flourished and herd contraction in years of drought when grasses were exhausted. The combination of strong commercial incentives and the weather cycle has led herdsmen to expand the use of rangelands to point where a joint World Bank-Botswana Government analysis in 1983 warned that the national carrying capacity was close to sustainable levels with a herd of almost three million head. The analysis also stated that as the country neared the limit of its sustainable carrying capacity, and available areas for cattle relocation diminished, management of grazing and water resources were critical and tenure reform was imperative.

The current project is directly responsive to this imperative and includes a sharp emphasis on land use planning which was absent in the First and Second Livestock projects.

Changing the traditional view of land use will not occur during the life of one project, as has been clear from the experience in the First and Second Projects. But change is essential if the cycle of herd expansion and contraction is to be broken and if the progressive degradiation of rangelands is to be stopped.

The completion of the current livestock project will probably not ensure that the livestock industry in Botswana will develop on a sustainable basis, but the project is a serious effort in that direction and, at this stage, the most viable option on the table. Some further changes in development strategy for the livestock sector will undoubtedly prove desirable, but we respect that the Bank's aim in this project is sustainable development of the industry. If a better option appears, we are prepared to discuss it with the Bank.

Mr. OBEY. Does the U.S. Government intend to ask the World Bank to take any steps to avoid or mitigate environmental damage from cattle grazing in Botswana?

Secretary BAKER. First, we are convinced that the Bank should continue its efforts to grapple with the problem. Livestock development in Africa has been controversial, but, given the traditional role of livestock and commercial realities, such development is likely to endure. The Bank has been forthright in acknowledging its failures and in seeking improved approaches. The honesty has earned our support.

Beyond that, we have received a number of suggestions which we want to examine further before endorsing. First, a broader approach to rural development in Botswana may offer opportunities for gainful activity to the rural population that present alternatives to herd expansion. Whether agriculture, industry or services offer such opportunities is not yet clear. Second, producer pricing policies may be having a perverse effect on incentives for livetock marketing. Third, the practice of having commercial ranch holders continue to use communal grazing lands appears to undermine the Bank's strategy. As we look further into these issues, other ideas may surface. Those that appear potentially useful will be discussed with the Bank.

Mr. OBEY. I am told that the project should at least be modified to remove the particularly sensitive Okavango Delta area from consideration; to your knowledge is the Bank looking at this possibility?

Secretary BAKER. There has been some confusion with regard to Bank supported project activity in the Okavango Delta.

For practical purposes, the only project activity that will affect the Okavango Delta is the strengthening of the Ngamiland District Planning Unit. The District Land Board which the Unit is designed to assist has legal authority over land use in the Delta because the Delta lies within the Ngamiland District and, with limited exceptions, is not designated by the central government as a reserved area. Only if the central governemnt were to designate a national park or other such reserved area would the Land Board authority be curtailed.

The credit component is unlikely to support any project activity in the Delta, since the area is still considered to be infested with tsetse fly and which can transmit deadly trypanosomiasis to cattle. Thus, commercial ranching is unlikely in the Delta as long as the infestation exists, and the Government has no present intention to encourage livestock development in the Delta.

On the other hand, you may be aware that the Botswana Government has been engaged in aerial spraying in the Delta for some time. Despite the Government's current intentions, we are concerned that livestock development could occur before policies to ensure sound land management, which take account of the Botswana interest in wildlife protection, become effective. Realistically, as grazing lands are degraded elsewhere in the country, the risk of pressures building to open the Delta to livestock are real—and no government of a pluralist democracy can ignore significant public pressures.

We have received a suggestion that the Delta might be suitable for multiple purpose development, including tourism based on the area's diverse wildlife. We will be examining this possibility further in the coming weeks. If it appears to have merit, we will discuss it with the Bank or with the IFC.

Mr. OBEY. It seems to me that projects like the one in Botswana, involving huge livestock development schemes in semiarid regions of Africa, are inherently questionable and should at least be subjected to detailed environmental scrutiny by the U.S. before approval by the Bank.

As part of U.S. early warning system, has Treasury developed criteria to identify such MDB projects that are potentially environmentally sensitive?

Secretary BAKER. To respond to your question, our early warning system is an important source of information on projects. The two types of cables I referred to earlier specifically ask whether environmental issues may be involved in the project. The standard paragraph included in the more detailed initial cable is as follows:

"Does the project raise any serious environmental issues? If so, to your knowledge have these been addressed adequately in the project design, or is further work likely to be required prior to Executive Board consideration? Projects which are likely to have adverse environmental consequences include irrigation, lumber industry, roads, resettlement, agricultural development and energy projects including hydroelectric and multipurpose dam projects. In particular, is the project likely to result in (1) the use of natural resources at an unsustainable level; (2) a threat to public health; (3) endangering species survival; (4) environmental degradation beyond recipient country boundaries; (5) the conversion or degradation of designated areas such as national parks, world heritage sites or wildlife reserves; (6) the impairment of land and other resources needed by indigenous people; or (7) the use of pesticides without adequate control?"

We do not rely exclusively on the early warning system to obtain information on projects. A major source of information is the development banks themselves. The bank staffs are usually candid in volunteering information on potential problems, and the post-project evaluation programs have produced some excellent critiques of past project activities that point to the potential problems in future projects. A second source of information has been private organizations with international contacts that have flagged issues that need attention.

While our information systems to identify environmentally sensitive projects are not foolproof, I believe that sufficient information has been coming to our attention to identify many such projects and to convince the banks eventually that systematic attention to these matters is essential, if shareholder support is to remain firm.

## AGRICULTURAL RESETTLEMENT PROJECTS

Mr. OBEY. Secretary Baker, as we discussed last year, the World Bank loaned $434.4 million in a total of six loans for a major road construction and agricultural resettlement project in Northwest Brazil in the early 1980s in the face of considerable international protest and concern over the environmental and socio-cultural risks of the program.

What has the World Bank learned from its disastrous experience with Polonoroeste?

Secretary BAKER. I would not want to speak on behalf of the Bank. But speaking on behalf of one of the Bank's shareholders, I believe an important conclusion to be drawn from this experience is that environmental and social aspects of certain development projects can not be planned and carried out as ancillary aspects of infrastructure projects. The time and attention to detail of environmental and social aspects and the testing needed to be certain of the method of attacking problems, all argue for carrying out these aspects well before some types of infrastructure investments are started.

Planning an implementing the environmental and social aspects of development activities before heavy investment in infrastructure also has the advantage of giving the borrowing government a much clearer idea of the political effects and degree of commitment that will be required to carry out development activities successfully.

Mr. OBEY. In retrospect, what factors do Bank staff think responsible for the problems with this project?

Secretary BAKER. A measured judgment on the part of the Bank will have to wait the post-project audit which will take place after the project is completed.

For our part, the fundamental decision to proceed with the road construction before the environmental and indigenous peoples protection aspects were in place and before health and agricultural extension agencies were functioning effectively in the region appears to have been an early source of major problems.

Mr. OBEY. How does the Bank plan to avoid future Polonoroeste like situations?

Secretary BAKER. One of the Bank's responses to the Polonoroeste experience is the 1982 tribal peoples policy where the bank undertakes to assist projects within areas used or occupied by tribal people only if the Bank is satisfied that best efforts have been made to obtain the voluntary, full and conscionable agreement (i.e., under prevailing circumstances and customary laws) of the tribal people or that of their advocates, and that the project design and implementation strategy are appropriate to meet the special needs and wishes of such peoples.

Secondly, the experience of the Polonoroeste program contributed, to a substantial degree, to a revision in May 1984 of the Bank's Operations Manual Statement (No. 2.36) regarding environmental aspects of Bank projects. The Statement stressed that the Office of Environmental and Scientific Affairs was responsible for ensuring that all required environmental measures are routinely incorporated in sector work and project design.

While encouraged by these steps, we believe that policy statements require consistent implementation to be meaningful. On this point, we believe that the disappointment associated with the initial years of the Polonoroeste program, and the associated public discussion, have provoked some pause and reexamination of project implementation. This reexamination seems serious and will hopefully lead to more successful projects.

Mr. OBEY. I want to get back to an issue I raised earlier—that the MDBs appear to be continuing to approve some very large loans for a catagory of projects with a poor past record of environmental and economic performance—namely, large agricultural resettlement schemes in tropical forest areas inhabited by indigenous and tribal peoples. The Polonoroeste Program in Brazil is only the latest example. I understand that these projects often involve high per capita investments to promote agricultural production in areas which as a whole may be exceedingly risky and unpromising due to generally poor soil quality and remoteness from markets.

As we discussed, the latest example of such a majority may have been the World Bank's approval last May of a fifth loan for planning and site selection in the Indonesian Transmigration Program, a plan to resettle millions of people to tropical forest regions with poor soils in the outlying islands of that country.

Mr. Secretary, would you expand on your earlier answer as to the Treasury Department's position with respect to this particular category of projects?

Secretary BAKER. Resettlement projects such as you describe are complex and difficult to implement well.

Having noted their difficulty, I would not presume that resettlement projects are necessarily bad investments or developmentally unsound. Each must be weighed on its separate merits.

Mr. OBEY. Does the Department share the concern of many environmental groups that resettlement projects in tropical forest areas are particularly risky from an environmental and economic point of view?

Secretary BAKER. Resettlement projects are complex, and complexity adds to the risk in project implementation. The quality of natural resources, such as soil, available for agricultural development is one element of risk. The potential for deforestation is a second risk. And the potential effects on current users of the land is a third type of risk. As one recent Bank report noted, "It should be recognized that there are no longer any 'unclaimed' lands in this world."

Having noted these factors, I should add that resettlement projects can be effective means of dealing with rural poverty.

A series of projects in the Jengka Triangle of Malaysia have succeeded in raising some 9,400 families from a condition of landless poverty to the middle class in the Malaysian context. While the projects could have been better planned from the point of view of the effects on wildlife and on current users of the land, the contribution toward poverty alleviation was significant.

Mr. OBEY. Are there less environmentally risky and economically more attractive investment opportunities for the MDBs in these countries?

Secretary BAKER. It is difficult to provide a general answer to the question. In the case of the Malaysia projects that I have mentioned, it is not clear how the development goal of helping the landless poor might have been achieved more effectively.

Mr. OBEY. As I understand it, the Indonesian loan is mainly for mapping, planning and site selection in remote tropical forest regions for proposed agricultural activities which, according to the Bank's own estimate, has a prospective rate of return below the opportunity cost of capital in Indonesia, a figure the Bank calculates at 10 percent (Appraisal Report, p. 37).

Is it of concern to Treasury that according to the Bank's own analysis, the $160 million Indonesian Transmigration loan doesn't even have an appraised rate of economic return?

Secretary BAKER. The absence of an economic rate of return in a project such as this which is designed to obtain information is not troubling or unusual. Projects without directly discernable outputs often omit rate of return estimates. Health projects are examples.

Mr. OBEY. Was this issue raised with Bank staff at any time? If so, what was the nature of the discussion?

Secretary BAKER. When we discussed the Transmigration V project with the Bank staff in June 1985, we were told that the project did not have a rate of return because it was a planning project. The Bank staff did not anticipate support for the later settlement construction phase of the project, apparently based on the judgment that such did not appear to be the best investment of resources under the transmigration program. The Bank staff was planning a Transmigration VI and appeared to believe that further investment in older settlement or in improving preparations for spontaneous migrants would be a better investment.

The Bank staff also made the point that with this project the Indonesian Government would have the facts to make a rational choice regarding the Transmigration program.

Mr. OBEY. Mr. Secretary, I understand that the World Bank has an official policy concerning protection of tribal peoples.

What assurances does the Treasury Department have that this policy will be carried out by the Indonesian Government during the actual settlement in Irian Jaya and Kalimantan?

Secretary BAKER. The Bank has provided us information regarding its conversations with the Indonesian Government on these points.

In Irian Jaya and Kalimantan, transmigration settlements would be located among people who are ethnically different, and who are in sparsely settled areas and relatively unacculturated. This is of concern to the Bank for two specific reasons. First, those who are relatively unintegrated into the larger society may be unaware of their own rights and interests or be unable to articulate or defend them effectively. Second, those who are either unacculturated or ethnically distinct need particular careful consideration to ensure that they benefit from development.

In order to overcome these concerns, the Government of Indonesia has affirmed to the Bank the following policy: (a) to develop transmigration settlements only when satisfied that they are technically, socially, economically and environmentally viable according to extensive studies carried out under the project; (b) to include, on a voluntary basis, the local people living in and around the proposed settlement areas with a view to raising their living standards to the same level as that of transmigrants; and (c) to give equal access to economic and social infrastructure and services to all sponsored and local transmigrants.

One of the most sensitive issues centers on the release of customary land use rights and the estimates of equitable compensation for local users.

The Bank advises that the Government of Indonesia affirms its intention to continue to reject sites for which agreements cannot be reached with local users or when the numbers of local people is such that the creation of a transmigration settlement would create serious conflicting land claims. The Bank notes, for example, that in Irian Jaya, the sites proposed under the project are located in the sparsely populated lowlands which are expected to have fewer land rights problems than in the highlands where the bulk of the indigenous population lives.

The site specific studies included in the project are to assess the need for other benefits including health services, roads, schools, extension, and possible resettlement, and preliminary recommendations on the types of benefits to be provided to local people. As many traditional cultivators are poorly prepared to do labor-intensive agriculture on one or two hectares, arrangements would be proposed for protecting such cultivators and for ensuring that their settlement within transmigration sites is gradual and voluntary. Particularly in Irian Jaya, where the majority of people have different farming practices and cultural traditions, site planning in the near future is expected to provide for parallel development activities for local residents.

Mr. OBEY. I've been told that the entire Transmigration V loan is supposed to generate information to be used to improve planning and site selection, but the Bank's appraisal report says "the major project risk would be that the Government of Indonesia may be unable to use the information provided under the project in a timely manner due to financial and managerial constraints."

Further on, the report reassures that "the plans will not be lost as they will still be useful for other regional or agricultural . . . projects or for subsequent transmigration programs." (Appraisal Report, p. 11)

Mr. Secretary, to what extent has Treasury reviewed the possibility of this risk and the extent to which the Bank will try to ensure that its planning recommendations are followed or can be followed? What leverage do we have in this regard?

Secretary BAKER. The project planning includes two specific elements designed to try to mitigate the risk that managers will not use the information developed. First, the Bank obtained agreement that key existing technical advisors would be extended to provide continuity for at least one additional year. Second, the project's simultaneous monitoring and evaluation component is designed to identify situations where pressures to accommodate transmigrants threaten to force decisions which do not conform to the information base.

At the present time, we have no reason to doubt that the Bank will argue strongly for conscientious assessment of information regarding settlement sites and for effective use of the information developed by the project.

Mr. OBEY. Is the Treasury Department satisfied with the quality and depth of these analyses given the size of this loan, and the risks that poorly implemented transmigration of hundreds of thousands of families pose for the environment, for indigenous peoples in the transmigration sites and for the transmigrants themselves?

Secretary BAKER. We have received no information to suggest that the technical quality of the information gathering systems or of the proposed analytic work will be inadequate.

### EFFECT ON NON-PROJECT LENDING ON THE ENVIRONMENT

Mr. OBEY. Mr. Secretary, one of the goals of the plan you unveiled last October to deal with the debt crisis in the developing world involves promoting sustainable, export oriented growth over the middle to long term in major debtor countries through the loan conditions of the public international financial institutions.

It seems to me that one of the lessons we've learned is that growth is sustainable in the long term if the natural resource base and the environment in debtor countries are not undermined in the process.

How is Treasury planning to ensure that the environmental underpinning of future growth in debtor countries is sustainably managed and not further undermined in the implementation of this plan?

Secretary BAKER. A major role of the development banks is and will continue to be to offer financial support and policy advice to countries as they implement their development strategies. The bulk of this support and advice will still be in the context of borrowing country investment programs. Adopting analytic techniques, such as "environment impact assessment" types of techniques, is an important way of ensuring that development is sustainable in the long term.

Over the last three years, the Treasury Department has been reviewing the environmental aspects of development bank activities and implicitly encouraging a more systematic use of the functional equivalent of "environmental impact assessment" techniques. In reviewing project proposals, sectoral studies or country studies, we have been probing to determine how effectively environmental and natural resource limitations and capacities have been assessed. This will continue.

It does not seem necessary to fasten a special feature on debt workout plans to address environmental considerations—in part, because the time horizon for these plans tends to be relatively short and, in part, because the same countries that are adopting debt workout plans are also the countries that we are reviewing from a perspective of sustainable development.

Many of the environmental problems resulting from development activities of the past have been associated with policies that sought to achieve allocation of resources, through price, expenditure and taxation policies, which could not accord with sustainable environmental or financial policies. To the extent that borrowing countries reassess their resource use policies, they are likely to have less environmental and financial stress. An example is the decision of the Government of Brazil to put aside the ambitious plan for a road network in the Amazon Basin which has been a policy goal of that Government for two decades.

Mr. OBEY. How is the Treasury Department currently promotimg environmental concerns in the non-project lending of the MDBs, for example, structural adjustment and sector loans?

Secretary BAKER. The Treasury Department is encouraging the adoption of policies which will allow countries to experience sustained economic growth. We are scrutinizing policy-based loans from this perspective.

We believe that market-oriented economic policies will encourage sound growth and a respect for natural resource and environmental limitations. In instances where this may prove not to be the case, we believe the development banks and the borrowers should examine appropriate policy adjustment. But such inconsistencies are likely to be few and far between.

Mr. OBEY. How can we ensure that macro-economic conditions attached to these increasingly important loans don't promote unsustainable uses of the environment and natural resources of developing countries?

Secretary BAKER. In our experience, problems affecting the environment or associated with unsustainable natural resource use have been the result of inappropriate microeconomic decisions and government-introduced distortions in the allocation of resources. Macro-economic conditions still leave governments wide discretion in the allocation of resources. If countries are to deal with their debt problems and restore sustainable growth, sustainable natural resource use would appear to be an integral necessity.

## ENVIRONMENTALLY BENEFICIAL PROJECTS

Mr. OBEY. Secretary Baker, last year the Committee drafted considerable bill and report language with respect to multilateral lending institutions and the environment, including a recommendation that the MDBs make a commitment to increase the proportion of their lending programs supporting environmentally beneficial and related projects.

Are we really getting the message through to the banks that they should be considering an increased proportion of funding that goes to smaller scale, less environmentally and indeed less economically risky projects?

Secretary BAKER. I think the banks understand that there is widespread concern regarding the environmental effects of some past project activities. And I think they are beginning to examine these activities—both past and proposed—in light of these concerns.

But it is just a beginning. We still see occasions when the banks succumb to the belief that a poorly conceived and harmful project, with their assistance, can be redeemed. On occasion, this belief may be justified. More often, the belief has been a self-delusion and has rationalized bank involvement in projects that have inflicted more harm on borrowing countries than benefit.

We should not lose sight of the other side. The banks have also supported well-conceived and beneficial project activity. We regularly encounter examples of small-scale, sustainable projects. We would like to see more such projects and are working with the staff of the State Department toward implementing an effective approach to the banks in these areas.

Mr. OBEY. How exactly does the Treasury Department plan to evaluate progress with respect to this recommendation?

Secretary BAKER. Your question raises the central issue in implementing this aspect of the legislation enacted last year. It would be all too easy—and largely unproductive—simply to urge an increased proportion of lending for environmentally beneficial projects. We would soon be inundated with project examples that without further investigation would appear to be beneficial—without being able to judge whether lending programs have been thoughtfully reevaluated or not.

Our approach to implementing the legislation is more deliberate, will take more time, but, I beleive, will yield more certain results. We plan to select specific types of environmentally beneficial projects and identify opportunities for such projects. Then, we plan to suggest to the banks that specific projects in specific countries be considered. Perhaps, some perceived opportunities may prove infeasible.

At the end of this process—perhaps, in a year or two—we should have examined a sufficient number of possible projects to reach relatively firm conclusions with regard to whether opportunities are being systematically assessed by the banks; and if not, why not. In the process, we may also find that specific projects, which would not otherwise have taken place, are planned and implemented.

Mr. OBEY. Is it possible to identify any positive changes thus far? If so, what are they?

Secretary BAKER. With regard to the recommendation for an increase in environmentally beneficial projects, it is too early to identify positive changes.

Mr. OBEY. Do the banks consider and analyze environmentally less risky alternatives in their identification and review of prospective projects, and in particular with regard to some of the larger scale rural development schemes and water projects such as Indonesian Transmigration and the India Narmada River Development program?

Secretary BAKER. We can not vouch that alternatives have been thoroughly examined in all cases, but we have found evidence that such examinations have occurred.

In the case of the Indonesia Transmigration Program, the World Bank appears to have given considerable thought to alternatives. The program is basically designed to provide gainful productive opportunities to the unemployed and underemployed on the island of Java. This goal could probably be achieved more effectively by investment in industry in Java. Certainly, better development opportunities in the outer islands lie in sustainable forestry development than in agriculture. The Bank has been discussing these alternative approaches with the Government of Indonesia for a number of years. However, a concordance of views on the needed policy changes has not yet been achieved.

The driving force behind the Narmada River development projects is the need for energy in the rapidly industrializing state of Gujarat. It is not clear whether thermal alternatives or opportunities for energy saving industrial processes have been thoroughly examined. However, in this instance, the positive evaluation and inclusion of alternatives might have delayed implementation, but would probably not have eliminated the need for hydroelectric development, in view of the large volume of energy desired.

In general, the examination of environmentally less risky alternatives occurs in some projects, but does not appear to occur in others. It's a mixed picture.

Mr. **Obey**. Can you tell me whether the MDBs, particularly the World Bank and IDB, have done anything recently to put more emphasis on energy conservation in their lending?

Secretary **Baker**. Yes. Both institutions have consistently sought to encourage power utilities to price their output to cover operations and maintenance costs. Realistic pricing policies for energy are widely acknowledged to be a vital component of any energy conservation effort.

The banks have not always been successful in obtaining such pricing policies, but they consistently make the negotiating effort. We support them in this effort.

Mr. **Obey**. How would you characterize the proportion of commitment to energy efficiency in MDB financed projects? Does the Treasury Department think that there ought to be more emphasis on energy efficiency in bank financed projects?

Secretary **Baker**. The opportunities for energy conservation in developing countries have been widely discussed. We would especially stress the importance of realistic energy pricing policies.

The banks generally acknowledge that more could be done to identify and benefit from energy conservation opportunities and express their intentions to support such opportunities. We hope to examine specific cases in the coming months.

Mr. **Obey**. Last year the Subcommittee recognized the efforts of AID in working with the World Bank to establish policies for the safe use of pesticides.

What has the Bank been doing to ensure implementation of these new guidelines?

Secretary **Baker**. In April 1985, the pest management guidelines were issued and, at the same time, were circulated within the Bank to all project staff as an Operations Policy Note, which carries the force of an administrative directive.

Mr. **Obey**. Are the Bank's pesticide guidelines being implemented on an individual project basis? Would you give some example of how they have been implemented?

Secretary **Baker**. The Operations Policy Note to which I referred made clear that "it is the responsibility of Bank missions to ascertain whether pest management is or will be appropriate and safe, and if necessary, to make appropriate recommendations to correct the situation."

In the course of discussing projects with Bank staff where pest management appears to be an element, we have made a point of asking whether the Bank's guidelines are being utilized.

In a $7.9 million 1983 IDA credit for cotton production in Madagascar, the then-current Bank guidelines were being used. The French Government was financing a separate component to develop non-chemical pest management techniques.

The 1985 $31.3 million IDA credit for drought relief in Ethiopia reflected careful use of the guidelines in financing the importation of pesticides.

The 1985 $33 million IBRD agricultural research project for Indonesia included a pest research component to be applied to cotton production.

Mr. **Obey**. Has the Treasury Department reviewed the multi-year international plan of the World Resources Institute for saving tropical forests?

Secretary **Baker**. Yes.

Mr. **Obey**. In consideration of their implementation strategy, would you describe what positive steps you feel that the Treasury Department may be able to make towards the goal of tropical reforestation?

Secretary **Baker**. The World Resources Institute study offers a large number of interesting project ideas. Tom Clausen has agreed that the study is useful. He has consented to further meetings with senior Bank staff to examine the feasibility of specific investment proposal in the coming years.

After discussing the proposals with the World Bank staff, we plan to have similar discussions with management and staffs of the regional development banks. I am hopeful that these discussions will identify development bank lending commitments which contribute substantially toward achieving the objective of protecting tropical forests in developing countries.

### AFRICAN DEVELOPMENT BANK

Mr. **OBEY**. The United States has been a member of the African Development Bank now for about two years.

In the past, there were allegations that the AFDB suffered from serious administrative weaknesses. Many analysts said it was simply not capable of growing faster or handling significantly larger sums of money.

What is the Administration's assessment?

The Administration has been seeking to increase the amount and the share of IDA money going to Africa. If your negotiations in the World Bank prove unsatisfactory, is it realistic to think we might switch a portion of our contributions from IDA to the African Development Bank?

Secretary **BAKER**. The African Development Bank in its current structure is still relatively new. It is an evolving institution that has come a long way since its inception but still has some distance yet to travel.

I do not believe we can expect the African Development Bank to play the same role in Africa that we envision for IDA. The African Development Bank is simply not yet in a position where it can formulate and administer a substantial program of policy-based lending of the kind we believe is needed in Africa.

### IIC/IFC DUPLICATION

Mr. **OBEY**. Last year the Department of Treasury said that the newly created Inter-American Investment Corporation would focus on small and medium scale enterprises in contrast to the World Bank's International Finance Corporation (IFC). The IFC recently extended until October 1987 a UNDP-sponsored Caribbean Project Development Facility which has the purpose of assisting small and medium size businesses in the region.

What is the current status of the IIC's organization and program operations?

How does its program differ from the expanded operations of the IFC and its Caribbean Project Development Facility?

Secretary **BAKER**. The IIC's Charter took effect at the recent meeting of the IDB's Governors in San Jose, Costa Rica. At present a search is underway for a general manager to head the IIC.

The IIC will differ from the IFC and the Caribbean Project Development Facility (CPDF) in several important ways. IFC generally puts together projects which are larger than $5 million. As you noted, the IIC will concentrate on small and medium scale enterprises (i.e. $500,000 to $5 million), below the cut-off for IFC involvement.

While the CPDF works with entrepreneurs to develop project proposals in the small and medium scale range, it does not invest funds directly in the project. The IIC, on the other hand, will be able to both develop project proposals and invest in projects. With the $200 million available to it, the IIC will be able to make a significant impact in meeting the capital needs of small and medium scale enterprises in the region.

In our view, IIC's capability to invest is crucial. The CPDF can play a role in obtaining financing for a project by helping the entrepreneur sell his concept to potential investors. The IIC, however, can back up its "stamp of approval" with an equity investment or a loan. In many instances the willingness of IFC to invest its own funds in a project has had a crucial catalytic effect in encouraging private investors to participate. We anticipate that the IIC will have a similar catalytic effect.

### ROLE OF COMMERCIAL BANKS IN PROGRAM FOR SUSTAINED GROWTH

Mr. **OBEY**. Mr. Secretary, the private banks have generally endorsed your "Program for Sustained Growth"; however, they seem reluctant to increase their lending.

Mr. deLarosiere, Managing Director of the IMF, in late January stated that commercial banks were jeopardizing the economic recovery of developing nations by cutting back on lending. He said that if lending cuts are not reversed, they "could undermine the efforts of countries making progress toward adjustment".

It appears that as yet there has not been any broad revival of private lending.

Mr. Secretary, could you explain why the private sector has failed, at least so far, to respond to the debt crisis with additional resources when 81 percent of Latin American and Caribbean external debt is owed to commercial creditors?

Mr. Secretary, are you contemplating any further actions to encourage increases in private bank lending?

Are the private banks requesting any further specific actions before they increase lending levels?

Why should we spend taxpayers' money and encourage increases in MDB lending and fast disbursement of MDB funds in order to assist in the solution of this crisis when the private banks themselves, which are at greatest risk, apparently are refusing to spend additional resources in order to solve the crisis which is in large part created by their own poor lending practices?

Secretary **Baker**. National banking groups in all major creditor countries—Canada, France, Germany, Italy, Japan, the Netherlands, Sweden, Saudi Arabia, the U.K., as well as the U.S.—have endorsed the debt initiative with its emphasis on growth-oriented economic reform in the debtor nations. As these nations implement credible reforms, have IMF programs in place where appropriate, and secure additional World Bank financing, additional commercial bank lending will be made available.

We estimate a need for $20 billion in net new lending by the commercial banks in support of these growth-oriented policies by the debtor nations over the next three years. We believe this new lending, in addition to that provided by the international financial institutions, is sufficient within a framework of cooperative efforts, to provide sustainable growth of five percent for the major debtors within this period.

It is in the banks' own self-interest to increase lending to countries making sound adjustment efforts. If these debtor nations adopt credible reforms, their creditworthiness and ability to service debt will improve. The banks will gain. At the same time, we do not support the use of government or World Bank guarantees or assurance of preferred creditor status for commercial bank loans as an inducement for new lending.

The U.S. taxpayer is not being asked to assist in solving the debt problem. The World Bank, for now, has ample capacity to increase annual lending by some $2-2.5 billion above FY 1985 levels. As we have stated before, we are prepared to consider a general capital increase for the World Bank if each participant does its part and demand for quality lending by the World Bank increases.

## PROJECT VERSUS NON-PROJECT LENDING

Mr. **Obey**. Mr. Secretary, I am concerned about a massive increase in non-project lending and fast-disbursing assistance from the Bank in order to meet third world debt needs. It seems to me that this is a risky proposal.

What happens to payments of this increased debt level if these funds and concomitant policy changes don't result in economic growth for third world countries?

What is your view of an appropriate mix of project and non-project loans at the Bank?

Secretary **Baker**. Some increased lending is essential in order to encourage and support the adoption of credible, growth-oriented reforms by the debtor nations. Without such reforms there will be no solution to the debt problem. We are, therefore, encouraging the World Bank to increase policy-based lending to assist the debtor nations in undertaking the necessary growth-oriented reforms, together with increased lending by the commercial banks. At the moment, the World Bank has structural or sector loan negotiations underway with 13 of the 15 major debtors.

In the past, the Bank has primarily emphasized project-specific loans. While it will continue to extend loans for worthy projects, we believe that it is important for new lending to encourage and support growth-oriented structural policy reforms which will increase economic efficiency and provide a firm foundation for stronger domestic growth. We don't have any target as to the appropriate mix of project/non-project lending.

## MULTILATERAL INVESTMENT GUARANTEE AGENCY [MIGA]

Congressman **Obey**. Mr. Secretary, we have been bilaterally funding the Overseas Private Investment Corporation for many years now. The 1987 Budget Appendix request funding for OPIC but also states: "The Administration has decided that the Corporation should be privatized. During 1986, the Administration will evaluate alternative means of achieving this objective." Now, the Administration is requesting $44.4 million for the Multilateral Investment Guarantee Agency. These two proposals seem contradictory. Will you be asking the Congress to privatize MIGA next year?

Both institutions are intended to provide political risk insurance against losses due to expropriation, inconvertibility and war damage; and to provide investment financing through loans and guarantees in order to increase international investment and trade flows. How is it that this Administration has now decided that a multilateral agency is better equipped than a bilateral agency to carry out this type of program?

Secretary BAKER. The Administration believes there is a case for privatizing OPIC and will be studying this question, however, no specific proposals have yet been formulated.

The MIGA is designed to be more than simply an insurance agency. In contrast to OPIC, it will have a strong mandate to promote investment policy reform in LDC's and will thus advance our development policy as well as promote better standards for investment protection. The MIGA will provide advice and technical assistance to developing member countries with the objective of improving investment conditions and removing impediments to investment flows. The Agency is also directed to promote and facilitate the conclusion of investment protection treaties among its members. Further, it will conclude bilateral and multilateral agreements with its members to assure that the investments guaranteed by it will receive treatment at least as favorable as that accorded by the member concerned to the most favored state or investment guarantee agency.

Due to its multilateral nature, MIGA will be better placed than a bilateral insurance agency to promote policy reforms. Most national insurance agencies are branches of export credit institutions and act accordingly. National insurance agencies tend to focus on individual transactions to increase the competitiveness of their investors and not on the broader questions relating to LDC investment policies. In addition, LDCs are likely to view MIGA's policy advice as more impartial than advice given by bilateral insurance agencies.

Mr. OBEY. Mr. Secretary, what other countries provide such guarantees on a bilateral basis? Is there likely to be true additionality of MIGA guaranteed investment over that which would otherwise take place?

Secretary BAKER. The following countries have official institutions extending investment insurance.

| *Country* | *Agency* |
|---|---|
| Australia | Export Finance and Insurance Corporation |
| Austria | Oesterreichische Kontrollbank A.G. |
| Belgium | Office National du Ducroire |
| Canada | Export Development Corporation |
| Denmark | Danish International Development Agency |
| Finland | Vientitakuulaitos |
| France | Banque Francaise du Commerce Exterieur Compagnie Francaise d'Assurance pour le Commerce Exterieur |
| Germany | Treuarbeit Aktiengesellschaft |
| India | Export Credit & Guarantee Corporation, Ltd. |
| Israel | The Israel Foreign Trade Risks Insurance Corporation Ltd |
| Italy | Sezione Speciale per l'Assicurazione del Credito all'Esportarione |
| Japan | Export Insurance Division Ministry of International Trade & Industry |
| Korea | Export/Import Bank of Korea |
| Netherlands | Nederlandsche Credietverzekering Maatschappij N.V. |
| New Zealand | Export Guarantee Office |
| Norway | Garanti-Instituttet for Eksportkreditt |
| South Africa | Credit Guarantee Insurance Corporation of Africa Limited |
| Spain | Compania Espanola de Seguros de Credito a la Exportacion, S.A. |
| Sweden | Exportkreditnaenden |
| Switzerland | Geschaftsstelle fur die Exportrisikogarantie |
| United Kingdom | Export Credits Guarantee Department |
| United States | Overseas Private Investment Corporation |

The Administration believes that the MIGA will stimulate additional flows of foreign direct investment to developing countries, not only as a result of its political risk insurance but more importantly because of its promotion of policy reform.

### EFFECTS OF OIL PRICE DECLINE ON MEXICO

Mr. **OBEY**. Because of the recent drop in oil prices, the earthquake, and other basic economic problems, Mexico is reportedly seeking a new program of debt relief from its creditors.

The last time Mexico got into international debt trouble in 1982, the United States provided major infusions of support, through the Exchange Stabilization Fund, to help Mexico cope with its immediate payments problems while the broader work of coordinating a longer term answer to the international debt crisis was under way. In some respects, it looks like we are in the same situation today as before.

Is the Administration planning, or is it prepared, to take any special steps to help Mexico now?

Secretary **BAKER**. No doubt, Mexico's balance of payments will be hurt this year by reduced oil prices. Nevertheless, declining oil prices are not the primary cause of Mexico's problems. The main problem is a budget deficit which was already running at about 10% of the GDP before oil prices started to decline. If Mexico succeeds in reducing its budget deficit to a manageable level and oil revenues stabilize, its external financing needs can be met in 1986 without extraordinary measures. The situation differs from that in 1982 because Mexico has significant reserves and the world financial system is not in imminent danger of collapse.

The Gramm-Rudman-Hollings legislation limits what the USG can do to help Mexico this year. We do stand ready, however, to assist through the normal financing channels of CCC and Eximbank guarantees, Paris Club debt relief, and support in the IMF and MDBs. In addition, if Mexico vigorously attacks the structural problems plaguing its economy, commercial banks would be willing to consider providing adequate funds to the GOM.

### INTEREST RATES, OIL PRICES, DOLLAR DEVALUATION

Mr. **OBEY**. Mr. Secretary, it seems to me that three major activities are occurring in the world economy which are extremely important—

1. Industrialized country interest rate decreases,
2. A major oil price decline, and
3. A significant fall in the value of the dollar.

How do you see each of these trends affecting the ability of third world developing nations to pay off their debts and how do you see each of these trends affecting the U.S. economy, trade deficit, and federal budget deficit?

I would like you to supply some detailed analyses of the effects of these changes for the record.

Secretary **BAKER**. These three effects will have a positive impact on most developing countries. The decline in LIBOR interest rates by some four percentage points between the second quarter of 1984 and the first quarter of 1986 should save the non-OPEC developing countries approximately $14 billion in debt servicing costs on an annual basis. Similarly, a lower oil price will also have a beneficial effect for most developing countries, both through the direct impact on the import bills of the oil importing countries as well as through the lower interest rates and higher growth rates it will induce in industrialized countries. In this regard, it has been estimated that in the first year after an oil price decline to $15/barrel, OECD area inflation could be as much as 2 percentage points "lower" and real GNP growth over one percentage point higher. Somewhat smaller effects would continue in the following year. A lower value of the dollar also on balance should be beneficial to most developing countries. A significant proportion of LDC debt is denominated in dollars, over 75 percent of LDC public long term debt according to World Bank estimates. A decline in the value of the dollar should then, reduce the real burden of this debt relative to LDC export earnings. Of course, the net effect of all these developments will not be positive for all developing countries. Some LDCs, notably the oil exporters, may find that on balance these developments make them worse off.

Lower interest rates should clearly have a favorable impact on the U.S. economy and budget. The benefits of lower interest rates are already evident in the figures on new housing starts which have averaged 2.0 million at an annual rate in the first two months of this year compared with about 1.75 million in both 1984 and 1985. The benefits are also evident in the nearly 10 percent reduction across the four quarters of last year in the interest costs to U.S. nonfinancial corporations.

These lower interest costs helped enable these corporations to sustain and improve profitability last year while prices of goods they sell were rising by only 2½ percent. As regards the budget, interest rates are currently one percentage point lower than the Administration forecast for all of 1986 when the budget assumptions were developed this past January. If sustained through the next fiscal year, a reduction of one percentage point in the structure of interest rates would reduce Federal outlays in FY-1987 by close to $10 billion from what had been expected.

Lower oil prices will also have a beneficial impact on the U.S. economy. A number of the major private econometric forecasting concerns have run lower oil prices through their models. The consensus appears to be that a drop in the price of oil of $10, if sustained, would raise the rate of real growth in the United States by about 1 percentage point in the initial year. Growth in the second year following the price decline would also be somewhat stronger than it otherwise would be. Inflation would be lower by 1½ to 2 percentage points in the initial year, and increases in consumer prices in subsequent years would also be dampened. Lower inflation would provide monetary authorities with increased room to pursue an accommodative policy. Of course, a fall in oil prices does contain some negative elements. The unemployment rate in Texas and some other energy producing states is already up sharply. Capital spending by the oil and gas industry is likely to be curtailed quite markedly. Drilling rig activity is down currently by some 45 percent from levels of late 1985. For the very short term, these negative elements could even outweigh the positive elements. Beyond a quarter or so, however, a decline in oil prices will be a definite plus for the U.S. economy.

It is extremely difficult to quantify impacts on the budget of lower oil prices, but on balance they should be strongly favorable. On the negative side, if current levels of oil prices on the spot market are translated into lower prices generally, including contract prices, then revenues from the windfall profits tax will be wiped out. Receipts from sales of leases of the outer continental shelf will be lower. These negative elements in the budget outlook would be more than offset by the lower cost of oil to the Federal Government (which purchases some 200 million barrels of petroleum products a year), by higher real incomes associated with higher real GNP, by reduced outlays for programs indexed to the cost of living, and by lower outlays for other programs as the lower rate of inflation is translated into lower prices of goods and services generally. On the receipts side, indexation of the individual income tax structure will be less, so that receipts will be higher for any given level of incomes. Overall, beyond some initial adverse impacts on the budget, lower oil prices should result in a significant improvement in the overall budget picture.

A lower value of the dollar, lower oil prices and interest rates should also contribute to an improvement in the U.S. balance of payments. Thanks in good part to these developments, the U.S. trade deficit in 1986 should be about $20 billion lower than we expected as recently as last fall. For 1987, the deficit should drop below $100 billion.

## FAIR EXPORT FINANCING PROGRAM

Mr. **OBEY**. Mr. Secretary, you have before us a new proposal for $300 million for an export war chest called the Fair Export Financing Program.

As I understand it, this program would allow you to meet subsidized export competition with additional grant funds.

Doesn't the Export-Import Bank already have this authority?

What is the need for this program if it doesn't do anything Eximbank-Import can't already do?

Why wasn't this money simply requested for the Export-Import Bank?

Secretary **BAKER**. Yes, Eximbank currently has the authority to meet subsidized export credit competition, but this would result in a substantial drain of Eximbank's already dwindling reserves. If the Congress wants us to undertake this proposal it should authorize the funds necessary.

The Administration's $300 million war chest is not intended merely to meet the competition. The war chest is a temporary program, primarily targeted at countries which have impeded our efforts to negotiate limits on the use of tied aid credits. The war chest will be used to initiate tied aid credits in markets or sectors of particular interest to those countries impeding negotiations.

The Treasury Department serves as chief U.S. negotiator for the OECD Arrangement. Therefore, it is appropriate that the Treasury Department administer the war chest to underscore that this is not a normal ongoing Eximbank program. This program is temporary and directly linked to progress in the negotiations. We hope to raise the minimum grant element on tied aid or mixed credits to a point that using them for other than legitimate aid purposes is too expensive.

Mr. OBEY. Anybody else have any questions?

Mr. KEMP. I do.

Thank you, Mr. Chairman.

### IMF AND INTERNATIONAL MONETARY POLICY

A senior Administration official recently was quoted as saying that the United States is going to the IMF Interdevelopment Committee meeting to listen with interest. That is kind of like an economist saying in the thirties while the economy of the world was decaying rapidly, it was time for an economic conference.

I want to get back to whether or not the United States is going to come up with some plan to help provide leadership on this critical issue at a moment so vital to the debt problems that you have alluded to and to the necessity of economic growth? How can we go listen? Isn't it obvious that there are ideas for a plan—even as controversial as they might be—isn't it time to come up with a plan and not keep waiting?

Secretary BAKER. It would be premature, Jack, and I think inappropriate for us to surface an Administration plan. In the first place, there is not one in existence. That has not so far been the charge from the President to Treasury. We do have two monetary studies on the table for consideration at that meeting. So we have made it very clear that in terms of fundamental reform of the International Monetary System it would be premature to really get into that before the Interim Development Committee meeting.

Mr. KEMP. Perhaps, but the G-5 meeting was a discussion of the failure of the floating exchange rate system and why there had to be more stability and why a coordinated interest rate drop was not in the best interest of this debt problem. That at least is an idea several people on both sides of the aisle, as well as Wayne Angle of the Federal Reserve Board, have talked about, some basket of commodity prices, as a way of targeting the conduct of monetary policy for the G–10.

Why? Well, I guess maybe the answer will be the same, but the question has to be repeated, isn't it time for us to stop talking down the dollar and starting to stabilize the dollar. And that in and of itself would lead I think to greater stability not only in exchange rates but ultimately in trade, in liberalizing the trade climate of the world.

Secretary BAKER. The more stability we can get in the exchange rate stream clearly the better it is; and you know the September exercise at the Plaza Hotel did not constitute an exercise in talking down the dollar.

Mr. KEMP. Interest rates?

Secretary BAKER. No, you are thinking about the January meeting in London on interest rates. But at the same time, the September meeting did not concern itself with fundamental reform of the International Monetary System. Neither did the January meeting of the G–5. That is a subject that is obviously very major in its scope. Any proposal or plan or scheme, if you will, that is embraced by the United States would have to be discussed in some detail with the other nations of the world. I think we ought to all recognize that any plan which looks toward a fundamental reform of the International Monetary System is a long term process. It is not something that in the history of the world has been done in a short period of time.

Mr. **Kemp**. It has been done a few times, done in '44 at Bretton Woods. Things we are discussing today came out of the Bretton Woods conferences. We didn't go into the conference with just an open mind, we went in there with Keynes' plan. The British came in with the Keynes plan, we came in with Harry Dexter White plan. That was an amalgamation of what Harry Dexter White and Maynard Keynes wanted. They came out with the World Bank, IMF, those facilities to help countries with short term balance of payments problem.

Today, it seems to me that you are to be congratulated for that G-5. I thought the interest rates were discussed at G-5.

Secretary **Baker**. At the London G-5, Jack, not the Plaza Hotel. The January G-5. The September G-5 was the one that had to do with the relative relationship of the currency.

Mr. **Kemp**. I want to predict here, in my view, coming from one member of the Congress, who is a supporter of this Administration, that the era of the floating exchange rate is over, that it collapsed at the Plaza, thanks to you. We recognize that the system was not working, it led to this explosion of debt and somebody is going to lead us back towards some convergence of currency. I hope it is you. I hope the sooner the better. But I am worried that we are going to miss this opportunity just by going to conferences and listening to everybody come up with these ideas. You either float or you fix. You can fix around the standard, you can fix around the basket, you can fix around indices. This floating system is gone and we have to realize, I think, your part in burying it.

Secretary **Baker**. How about a semi-float?

Mr. **Kemp**. You can't.

Secretary **Baker**. Would you be for a quasi-float?

Mr. **Kemp**. I want to praise somebody in Brazil who turned down a $150 million loan from the World Bank, a city in Brazil. They gave as the reason for not taking the money that they had no need for more debt because you have to pay back with interest. That means higher taxes, and the village held a meeting and all the villagers raised their hands in opposition to the loan. It is amazing how smart people can be when they are led by common sense, and not by people who think more debt is necessarily the answer.

I think we ought to stop trying to push more debt on the Third World and let's encourage them to change the policies that brought about the debt in the first place, and let's get our own interest rates down. That is the key. We shouldn't be talking the dollar down, we should be talking interest rates down. There is no reason for these interest rates to be this high at this point with inflation about nil in this economy.

Mr. **Kemp**. With farmers and energy companies in your home state, and banks in your home state, why should we worry so much about the Multilateral Development Bank when we have got banks in the Midwest and in the Southwest that are in trouble——

Secretary **Baker**. I hope you will agree with me that we are not trying to push additional debt on these countries. The proposal we are talking about, the keystone of it, as you well know, is fundamental economics reform by the debtor nations.

Mr. **Kemp**. Keep the IMF out of it because otherwise they are going to devalue the currency. You and I are trying to stabilize it. Uncle Whiskers may not be telling them what you do, as you so coyly mentioned, but I will tell you I think IMF is Yankee imperialism, and I will tell you what it is, it is imperialistic economic policy for IMF to go in and tell these countries to devalue, raise taxes, squeeze those people's economy, with unemployment 50 percent in some countries.

Secretary **Baker**. Well, if you take a look at our proposal, which I am sure you have done in detail, you will see there we are not really talking about that. We are talking about implementing growth oriented, market oriented economic measures, Jack, over the long term. I don't think you would have any quarrel whatsoever with this approach. At the same time, you do have to have balance of payments adjustments.

[Questions and answers for the record follow:]

## Questions and Answers for the Record

### ASSISTANCE FOR AFRICA

Mr. **McHugh**. In responding to my question about the article in the Washington Times, a copy of which is attached, Secretary Baker mentioned the significant bilateral assistance the United States provides to Sub-Saharan Africa as well as his proposal to target a substantial portion of IMF Trust Fund repayments toward meeting the financial crisis in Sub-Saharan Africa. Those comments, however, do not respond to the basic points made in the article. Using figures prepared within the World Bank, the story indicated that Sub-Saharan Africa will need at least $11 billion a year in concessional resources until 1990 in order to maintain per capita GNP at current levels. The story further indicated that there is, at present, a $2.5 billion in per year gap in concessional resources that needs to be filled, of which perhaps $1 billion can be met by multilateral sources assuming an IDA VIII replenishment of at least $12 billion and that a substantial portion of IMF Trust Fund repayments are provided to Africa. Obviously, the other $1.5 billion will have to come from bilateral donors or debt rescheduling, but the story is not very optimistic on that count. Does the Treasury Department agree with this assessment of Africa's financing needs? If not, why not?

Secretary **Baker**. Calculations of financing are necessarily predicated on specific assumptions regarding such things as export growth rates, import requirements, and future flows of concessional and non-concessional resources. These assumptions cover both the international environment in which the African countries operate as well as policy actions taken by the African countries themselves. These assumptions may, or may not, come to pass. For example, lower oil prices will, on the whole, have a positive impact on many Sub-Saharan African countries, both directly through lower oil bills as well as indirectly through the higher export levels and lower interest and inflation rates they will generate. At present, it is difficult to forecast oil prices one week in advance, much less several years into the future. This said, it is clear that in spite of an improved international economic environment resulting from lower oil prices, the availability of external finance will be a serious constraint for many African countries in the near term. This will require that African countries themselves make maximum efforts to mobilize their own domestic resources. It will also require that donors make the best use of scarce concessional resources through better coordination as well as making maximum efforts to support African countries undergoing serious economic reform efforts.

Mr. **McHugh**. What specific progress has been made in persuading other nations to target IMF Trust Fund repayments on Africa and other poor nations?

Secretary **Baker**. Both the IMF and World Bank Boards recently approved the U.S. proposal to use IMF Trust Fund reflows in conjunction with World Bank resources to support comprehensive economic policy reforms in IDA-eligible countries with protracted balance of payments problems.

The Trust Fund arrangement will enable the IMF, World Bank and the recipient country to work together to develop a comprehensive policy framework which will serve as the basis for separate landing agreements between each of the institutions and the recipient country.

Funding resources will include $3.1 billion in reflows to the IMF Trust Fund, and roughly equivalent resources from the World Bank, principally IDA, the soft-loan window of the Bank. In addition, we hope that the development of a coherent policy framework for borrowing countries will catalyze bilateral contributions to be utilized in association with Trust Fund arrangement programs.

We were extremely pleased by the IMF and World Bank Boards' decisions to support our proposal. Comprehensive enconomic policy reform is the most important step toward countering economic stagnation in the poorest countries and setting the stage for a resumption of sustainable growth.

Mr. McHugh. Are we likely to see an IDA VIII replenishment of $12 billion?

Secretary Baker. All donors other than the United States have expressed support for a $12 billion IDA VIII replenishment; a number view $12 billion as a minimum. For most donors, $12 billion is essential for IDA to play the enhanced role in promoting structural adjustment and growth envisioned for it in the United States, Trust Fund proposal. This proposal has now been endorsed by the Executive Boards of both the Bank and the International Monetary Fund.

We have stated that given the progress on the Trust Fund proposal—and assuming progress on other issues, e.g., adjustment in lending terms, the country allocation of resources—we are hopeful that the United States could consider a $10.5—$12.0 billion range at future negotiating sessions. We stressed, however, that because of serious U.S. budget uncertainties it is not now possible for the United States to discuss a specific number.

The United States has worked hard with Bank management and other donors to fashion an operational framework for IDA VIII which would ensure the effective use of resources. We are very encouraged by the progress achieved to date, particularly by the comprehensive approach of the Trust Fund proposal in which IDA and other resources will reinforce needed policy reform, particularly in Sub-Saharan Africa. We are therefore hopeful that the final operational framework negotiated for IDA VIII will constitute a cost-effective vehicle for promoting U.S. economic, strategic and humanitarian interests in recipient countries and that it will merit strong Congressional support.

Mr. McHugh. How large would the IDA VIII replenishment have to be to maintain both IDA and Special Facility lending to Sub-Saharan Africa at current levels in real terms after inflation is taken into account (assuming no change in the percentage of IDA lending targeted for Africa)?

Secretary Baker. On the basis of current exchange rates, commitments from IDA VII ($9 billion) and the Sub-Saharan Africa Facility ($1.6 billion) are projected to total approximately $10.6 billion, with Sub-Saharan Africa accounting for over $4.8 billion, i.e., 36 percent of IDA VII plus the full SSA Facility. An IDA VIII in the range of $12—12.5 billion would be required to maintain current lending in real terms.

## GROWTH WITH EQUITY AND POLICY REFORM

Mr. McHugh. The Baker Plan has been described as an effort, in part, to stimulate economic growth in the developing nations, many of whose economies have been experiencing serious troubles, and as a way of providing greater lending to developing nations in exchange for their commitment to implementing economic policy reforms. Is that a fair characterization?

The Alliance for Progress stimulated significant economic growth in Central America in the 1960s and 1970s. However, the benefits of that growth were not widely distributed, a result the United States is still attempting to cope with today. What steps are being taken by the Administration and by the MDBs to insure that the benefits of economic growth stimulated by MDB lending are distributed equitably?

What safeguards are being taken to insure that policy reforms supported by the MDBs, especially the World Bank, do not worsen the economic situation of the poorest people?

What has the Treasury Department done to insure that the MDBs take this problem into consideration in designing adjustment programs?

Secretary BAKER. The "Program for Sustained Growth" rests on policy reform in developing countries, supported by net new lending by the commercial banks and enhanced structural and sectoral adjustment lending by the MDBs, particularly the World Bank.

The focus of the program is on improving the prospects for growth in the debtor nations as the only viable solution to their debt problems. The adoption of more market-oriented economic policy reforms should also help increase opportunities for all segments of the economy by reducing distortions that most often reinforce inequitable distribution of income.

Mr. MCHUGH. There has been a sharp decline over the last four years in the share of World Bank lending for rural development projects, which traditionally have been the Bank's primary way of attacking poverty in developing nations. In particular, as I understand it, rural development lending has fallen from 18% of Bank lending in fiscal 1981 to 10.9% in fiscal 1985. Is this something that the Department is concerned about? If not, why not? If so, what steps is the Treasury Department taking to reverse this trend? Have we made this a priority item for discussion in the IDA VIII replenishment negotiations?

Secretary BAKER. We are committed to increasing the effectiveness of the Bank's development efforts, and believe there is a strong complementarity between the twin objectives of efficient economic growth and alleviation of poverty. While some categories of projects are categorized as "Directly Poverty Oriented", other projects can and do contribute significantly to poverty alleviation. In agriculture, for example, a review of eight FY 85 projects indicated that 47 percent of the beneficiaries were in the poverty target group.

It is true that lending to rural development declined as a percentage of total Bank lending from an annual average of 14.4 percent in FY 79-83 to 8.0 percent in FY 84, before increasing somewhat to 10.9 percent in FY 85. However, if you include lending for agriculture—which is also highly poverty oriented—the percentages for "agriculture and rural development" are about the same, i.e., 27 percent in FY 79-83, 22.4 percent in FY 84 and 26 percent in FY 85. We also expect that FY 86 lending to agriculture and rural development will be higher than the FY 79-83 annual average with preliminary budget projections indicating that a 33 percent share is possible.

In discussing IDA VIII negotiations, it is important to realize that the focus of IDA lending operations is strongly directed to the very poorest countries. While Executive Directors have in principle determined income per capita of $790 (1983 $) to be the level beyond which countries would not receive IDA funds, IDA lending is in fact concentrated on countries with incomes below $550 per capita with 94 percent of commitments allocated to countries whose per capita incomes are below $400; this is an increase above the 87 percent recorded in FY 79-83. We are also continuing to work with management and other donors to increase the share of IDA lending to Sub-Saharan Africa reflecting the relative poverty of the region. It should also be noted that IDA lending to India and China—two countries judged creditworthy for IBRD lending—has been concentrated on the social and rural sectors, which are sectors of poverty and vast need.

Mr. MCHUGH. Another area of concern is World Bank lending in the primary health sector. Bank lending in this area currently amounts to only about 1 percent of its total lending. Do you think that is good enough? If so, why? If not, what are we doing about it?

Secretary BAKER. IBRD/IDA lending to "Population Health and Nutrition" accounted for 0.7 percent of FY 79-83 Bank lending. We are pleased to note that the share of lending to this sector has increased; to 1.6 percent in FY 84 and 1.3 percent in FY 85. The share projected for FY 86-88 is 2 percent.

Mr. MCHUGH. What specific steps has the Treasury Department taken since 1981 to insure that the World Bank remains committed to alleviating the worst manifestations of absolute poverty in its lending programs?

Secretary BAKER. The Treasury Department is very seriously concerned by the problems of absolute poverty and this concern is fully shared by World Bank management. The Bank's operational staff are frequently reminded of the importance of the poverty alleviation objective in operational work. It is management's objective—a goal which we strongly support—to ensure staff at the stage of project design "carefully identify the means available to direct lending to benefit the poor to the extent possible within the overall constraint of the project's economic viability." Management is also seeking to improve the treatment of poverty issues in the Bank's Country Program Papers.

The problem of the very poorest people is one of particular Bank concern. A policy paper on how lending operations can be better geared to reaching these "ultra poor" is currently under preparation.

We believe the emphasis the United States places on maximizing lending effectiveness will also contribute to poverty alleviations. In this context, the Bank is working hard to improve its operations in Sub-Saharan Africa, and there is a donor consensus to increase the share of concessional IDA resources going to this region.

### Free Market Principles and the "Trickle-Down" Theory

Mr. **McHugh**. The Administration has argued that greater privatization and reliance on free market principles will create jobs, which in turn will provide increased purchasing power for the poor majority. Isn't that the essence of what has come to be called the "trickle-down" theory of economic development.

Secretary **Baker**. We want to see the MDBs put more emphasis on the private sector because we believe that reliance on market mechanisms promotes efficiency and brings about a more productive allocation of resources. Privatization is an important element in policy reform in borrowing countries. It is also a key part of our negotiations of replenishments for the MDBs and of our review of their ongoing lending programs. The IDB has set up the Inter-American Investment Corporation to help finance private sector projects in its borrowing countries and the Multilateral Investment Guarantee Agency has also been established to help increase the flow and capital to the private sectors of developing countries. Another favorable development has been an agreement to the doubling of IFC capital which will provide additional new support for the private sector.

### Corruption

Mr. **McHugh**. Last week we had an interesting discussion with Peter McPherson regarding the issue of corruption in the developing nations. There was a consensus among the Subcommittee members on both sides of the aisle that it was not enough a ~~simply to~~ be able to ensure that our funds, whether provided through AID or the MDBs, are protected. There was agreement that we should probably not be encouraging substantial lending to countries where corruption is rife since it does little good for us to put money in at one end if the government is taking it out at the other. Do you agree with that in principle? If so, how can an issue like this be addressed when the MDBs allocate their limited resources?

Secretary **Baker**. I certainly agree that corruption in economic terms is inefficient. It distorts serious efforts to reform the economy and we adamantly oppose MDB loans when this is believed to be a problem.

Mr. **McHugh**. There was also a view expressed by one member that the issue of corruption was easier to deal with in our bilateral assistance program, and thus that we should be scaling back our assistance to multilateral institutions like the MDBs. Do you agree with that?

Secretary **Baker**. No. I do not believe there is any inherent reason to believe that corruption involving bilateral assistance is any easier to deal with than corruption of MDB finance.

### Criticisms of MDB's

Mr. **McHugh**. One of the criticisms of the MDBs is that there is pressure to insure that some funds are provided to every country, and thus that resources are not targeted on those necessarily pursuing the best economic policies. Do you agree with that criticism? If so, what are we doing to change that?

Secretary **Baker**. This Administration strongly agrees with your view that scarce MDB resources should be allocated to those recipients which can make the best use of them. In this regard, one of major recommendations of the far-reaching Assessment of the MDBs conducted by the Administration was that "annual country and sector levels should be more flexible and less target oriented." We have insisted on higher loan qualify in the Executive Board—where we have opposed numerous projects for economic and/or financial reasons—and privately with senior MDB managements.

We believe that our efforts to reduce so-called "targetry" have been broadly successful. Several Sub-Saharan African nations which pursued unsound socialist economic policies found their access to new World Bank funds sharply circumscribed, as they could not make good use of additional MBD resources. Similarly new World Bank lending to Burma has been minimal in recent years, and totally non-existent for Afghanistan and Vietnam.

## U.S. OPPOSITION TO MDB LOANS

Mr. **MCHUGH**. I am attaching a table you provided two years ago showing proposed MDB loans that the U.S. abstained or opposed. Please update that chart for the record.

Secretary **BAKER**. Attached is an updated table showing all U.S. negative votes and abstentions on projects in the MDBs for economic/financial reasons since the start of USFY 1975. This table includes our opposition to projects due to unresolved expropriation problems, but it does not include projects opposed because of abortion. Information on all U.S. votes in the MDBs is submitted to the Congress quarterly as part of Treasury's compliance with human rights legislation.

## U.S. Negative Votes and Abstentions in the MDBs for Economic and/or Financial Reasons
### USFYs 1975-1986

| Institution | Date | Country | Amount ($ millions) | Project | Vote | Reason |
|---|---|---|---|---|---|---|
| FY 1975 | | | | | | |
| IBRD | Dec. 1974 | Nigeria | 21.0 | Agriculture | Abstain | Need for capital transfer questionable |
| IBRD | Dec. 1974 | Nigeria | 19.0 | Agriculture | Abstain | Need for capital transfer questionable |
| IBRD | Dec. 1974 | Nigeria | 21.0 | Agriculture | Abstain | Need for capital transfer questionable |
| IBRD | Dec. 1974 | Nigeria | 29.0 | Agriculture | Abstain | Need for capital transfer questionable |
| IBRD | Dec. 1974 | Nigeria | 17.5 | Agriculture | Abstain | Need for capital transfer questionable |
| IDB | Oct. 1974 | Costa Rica | 50.5 | Power | No | Excessive loan terms |
| ADB | Nov. 1974 | Indonesia | 11.5 | Water Supply | No | Need for concessional funds questionable |
| ADB | Nov. 1974 | Indonesia | 2.7 | Ag. Credit | No | Need for concessional funds questionable |
| ADB | Nov. 1974 | Sri Lanka | 1.5 | Earth Satellite Station | Abstain | Unjustified cost overrun |
| ADB | Nov. 1974 | Sri Lanka | 1.0 | Mineral Sands | Abstain | Unjustified cost overrun |
| ADB | Apr. 1975 | Thailand | 22.7 | Mae Moh Power | Abstain | Unjustified cost overrun |
| FY 1976 | | | | | | |
| IBRD | Jul. 1975 | Honduras | 3.0 | Port | No | Unjustified cost overrun |
| IBRD | Dec. 1975 | Algeria | 46.0 | Cement | No | High cost |
| IDA | Jan. 1976 | Afghanistan | 10.0 | Agriculture | Abstain | Unjustified cost overrun |
| IDA | Mar. 1976 | Benin | 9.0 | Roads | Abstain | Unjustified cost overrun |
| IDA | Mar. 1976 | Cameroon | 15.0 | Roads | Abstain | Unjustified cost overrun |
| ADB | Sept. 1975 | Nepal | 0.5 | Jute Development | No | Unjustified cost overrun |
| ADB | Nov. 1975 | Burma | 6.1 | Power Transmission | Abstain | Unjustified cost overrun |
| ADB | Dec. 1975 | Nepal | 2.5 | Power Transmission | Abstain | Unjustified cost overrun |
| ADB | Jun. 1976 | Afghanistan | 10.8 | Agriculture | No | Unjustified cost overrun |

| Institution | Date | Country | Amount ($ millions) | Project | Vote | Reason |
|---|---|---|---|---|---|---|
| FY 1977 | | | | | | |
| IBRD | Dec. 1976 | Congo (PDR) | 8.0 | Education | No | Expropriation |
| IDA | Sept. 1976 | Tanzania | 8.0 | Tobacco | Abstain | Inefficient use of resources |
| ADB | Sept. 1976 | Nepal | 4.8 | Roads | Abstain | Unjustified cost overrun |
| FY 1978 plus Transition Quarter | | | | | | |
| IBRD | Feb. 1978 | Malaysia | 26.0 | Palm Oil | Abstain | Surplus commodity |
| ADB | Oct. 1977 | Nepal | 5.0 | Agriculture | Abstain | Unjustified cost overrun |
| AFDF | Oct. 1977 | Ethiopia | 7.8 | Transport | Abstain | Expropriation |
| AFDF | Jan. 1978 | Benin | 5.0 | Agriculture | Abstain | Inadequate rate of return |
| AFDF | Jan. 1978 | Upper Volta | 7.2 | Transport | No | Inadequate rate of return |
| AFDF | Mar. 1978 | Rwanda | 2.5 | Agriculture | Abstain | Unjustified cost overrun |
| FY 1979 | | | | | | |
| IFC | Jun. 1979 | Ecuador | 50.5 | Industry | Abstain 1/ | Excessive tariff protection |
| ADB | Dec. 1978 | Nepal | 14.0 | Agriculture | No | Absorptive capacity |
| ADB | Dec. 1978 | Pakistan | 32.1 | Industry | No | Inappropriate development strategy |
| ADB | May 1979 | Indonesia | 8.0 | Water Supply | No | Unjustified cost overrun |
| AFDF | Dec. 1978 | Kenya | 5.5 | Water Supply | No | Absorptive capacity |
| AFDF | Dec. 1978 | Lesotho | 5.2 | Agriculture | No | Inadequate rate of return |
| AFDF | Feb. 1979 | Ethiopia | 8.6 | Water Supply | No | Expropriation |
| FY 1980 | | | | | | |
| IDB | Dec. 1979 | Colombia | 44.0 | Hydroelectric Power | Abstain | Inadquate rate of return |
| AFDF | Apr. 1980 | Ethiopia | 9.7 | Rural Roads | No | Expropriation |
| AFDF | Aug. 1980 | Ethiopia | 8.9 | Tea Industry | No | Expropriation |
| FY 1981 | | | | | | |
| IBRD | Jan. 1981 | Guyana | 22.0 | Structural Adj. | Abstain | Inappropriate macro-economic policies |
| IDA | Dec. 1980 | Ethiopia | 40.0 | Agriculture | No | Expropriation |
| IDA | May 1981 | Ethiopia | 35.0 | Education | No | Expropriation |
| IDB | Dec. 1980 | Mexico | 80.0 | Fishing | Abstain | Inadequate economic justification |

| Institution | Date | Country | Amount ($ millions) | Project | Vote | Reason |
|---|---|---|---|---|---|---|
| FY 1981 (cont.) | | | | | | |
| IDB | Jan. 1981 | Mexico | 165.0 | Agriculture | No | Lending rate controversy |
| IDB | Jun. 1981 | Colombia | 10.0 | Marine Seismic Studies | Abstain | Inappropriate pricing policies |
| IDB | Aug. 1981 | Guyana | 20.0 (FSO) | Agriculture | No 2/ | Inappropriate sector policies |
| FY 1982 | | | | | | |
| IBRD | Jan. 1982 | Nicaragua | 16.0 | Municipal Development | No | Inappropriate macro-economic policies |
| IBRD | Feb. 1982 | Bahamas | 5.8 | Urban Project | Abstain | Lack of replicability |
| IBRD | Apr. 1982 | India | 200.0 | Oil Refineries Rationalization | No | Potential displacement of foreign private capital and inappropriate sector policies |
| IBRD | Jun. 1982 | Ivory Coast | 101.5 | Offshore Petroleum Exploration and Development | Abstain | Potential displacement of foreign private capital |
| IBRD | Aug. 1982 | Peru | 81.2 | Onshore Petroleum Development | Abstain | Potential displacement of foreign private capital |
| IDA | Jun. 1982 | Ethiopia | 30.0 | Development Finance | No | Expropriation |
| IDB | Jan. 1982 | Nicaragua | 0.5 (FSO) | Agriculture (technical assist.) | No 2/ | Inappropriate macro-economic policies |
| IDB | Jul. 1982 | Nicaragua | 0.5 3/ | Artisanal Fishing Co-ops | No | Inappropriate macro-economic policies |
| IDB | Sept. 1982 | Nicaragua | 34.4 | Hydroelectric Power | No | Inappropriate macro-economic policies |
| ADB | Dec. 1981 | Malaysia | 20.6 | Fishing | Abstain | Poor project design |
| AFDF | Oct. 1981 | Ethiopia | 12.8 | Rural Roads | No | Expropriation |
| AFDF | Oct. 1981 | Seychelles | 8.6 | Water and Sewerage | No | Ineligible for concessional funds |
| AFDF | Dec. 1981 | Ethiopia | 10.7 | Fuelwood | No | Expropriation |
| AFDF | Mar. 1982 | Mozambique | 11.0 | Irrigation/Dam | Abstain | Inadequate rate of return |
| AFDF | Aug. 1982 | Zambia | 0.6 | Farming Estates Feasibility Study | Abstain | Doubtful economic viability of future project |
| AFDF | Sept. 1982 | Niger | 6.1 | Health Science School | Abstain | Unjustified cost overrun and inadequate economic justification |
| AFDF | Sept. 1982 | Ethiopia | 8.0 | Development Finance | No | Expropriation |

| Institution | Date | Country | Amount ($ millions) | Project | Vote | Reason |
|---|---|---|---|---|---|---|
| FY 1983 | | | | | | |
| IBRD | Oct. 1982 | India | 165.5 | Krishna-Godavari Petroleum Exploration | No | Potential displacement of foreign private capital and inappropriate sector policies |
| IBRD | Jan. 1983 | China | 162.4 | Daqing Oilfield Secondary Recovery | No | Potential displacement of foreign private capital and inappropriate sector policies |
| IBRD | Feb. 1983 | India | 222.3 | South Bassein Offshore Gas Development | No | Potential displacement of foreign private capital and inappropriate sector policies |
| IBRD | Mar. 1983 | China | 100.8 | Zhongyuan-Wenliu Petroleum Exploration and Development | No | Potential displacement of foreign private capital and inappropriate sector policies |
| IBRD | May 1983 | Egypt | 165.3 | El Dikheila Reinforcing Bar 4/ | Abstain | Not a developmental priority |
| IDA | Mar. 1983 | Ghana | 13.0 | Water Supply Rehabilitation | Abstain | Inappropriate macro-economic policies |
| IDA | May 1983 | Ethiopia | 20.0 | Urban Development | No | Expropriation |
| IDA | May 1983 | Ghana | 11.0 | Energy Project | Abstain | Inappropriate macro-economic policies |
| IDA | Jun. 1983 | Ethiopia | 7.0 | Petroleum Exploration Promotion and Geothermal Study | No | Expropriation |
| IDA | Jul. 1983 | Ethiopia | 70.0 | Roads | No | Expropriation |
| IDA | Jul. 1983 | Tanzania | 35.0 | Mtera Hydropower | Abstain | Inappropriate macro-economic policies |
| IFC | May 1983 | Egypt | 31.2 loan 5/<br>+7.2 equity | El Dikheila Reinforcing Bar 4/ | Abstain | Not a developmental priority |
| IDB | Jul. 1983 | Nicaragua | 0.5 6/ | Furniture Production | No | Inappropriate macro-economic policies |
| IDB | Aug. 1983 | Guyana | 27.8 (OC) +<br>10.0 (FSO) +<br>1.05 T.A. | Abary II rice irrigation | No 7/ | Inappropriate sector policies |
| IDB | Sept. 1983 | Nicaragua | 30.7 (OC) | Fishing Industry Rehabilitation | No | Inappropriate macro-economic policies |

| Institution | Date | Country | Amount ($ millions) | Project | Vote | Reason |
|---|---|---|---|---|---|---|
| FY 1983 (cont.) | | | | | | |
| ADB | Dec. 1982 | Thailand | 87.0 | Offshore Gas Pipeline | Abstain | Potential displacement of foreign private capital |
| ADF | Dec. 1982 | Bangladesh | 45.0 | N.W. Rural Development | No | Absorptive capacity |
| AFDB | Sept. 1983 | Kenya | 28.5 | Kenya-Sudan Link Road | No | Inadequate rate of return |
| AFDF | Nov. 1982 | Ethiopia | 14.8 | Water Supply | No | Expropriation |
| AFDF | Nov. 1982 | Mauritania | 2.7 | Irrigation | Abstain | Unjustified cost overrun |
| AFDF | Mar. 1983 | Ethiopia | 18.0 | Education | No | Expropriation |
| AFDF | Apr. 1983 | Tanzania | 22.6 | Road, Water Supply, Bridges, Irrigation | Abstain 8/ | Unjustified cost overrun |
| AFDF | Jun. 1983 | Ethiopia | 24.4 | Gore-Tepi Road | No | Expropriation |
| FY 1984 | | | | | | |
| IBRD | Mar. 1984 | Hungary | 90.0 | Petroleum Project | No | Potential displacement of foreign private capital |
| IBRD | Mar. 1984 | India | 242.5 | Cambay Basin Petroleum Project | No | Potential displacement of foreign private capital and inappropriate sector policies |
| IBRD | Mar. 1984 | Nigeria | 25.0 | Gas Technical Assistance | No | Potential displacement of foreign private capital |
| IBRD | Mar. 1984 | Zambia | 75.0 | Copper Industry Rehabilitation | No | Doubtful financial viability |
| IBRD | May 1984 | China | 100.3 | Karamay Petroleum Project | No | Potential displacement of foreign private capital and inappropriate sector policies |
| IBRD | May 1984 | Hungary | 24.3 9/ | Petroleum Project | Abstain | Potential displacement of foreign private capital |
| IBRD | Sept. 1984 | Philippines | 150.0 | Agricultural Sector Inputs | No | Inadequate sector reform conditionality |
| IDA | Dec. 1983 | Ethiopia | 35.0 | Second Coffee Processing and Marketing | No | Expropriation |

| Institution | Date | Country | Amount ($ millions) | Project | Vote | Reason |
|---|---|---|---|---|---|---|
| FY 1984 (cont.) | | | | | | |
| IDA | Jun. 1984 | India | 220.0 | National Co-Operative Development | No | Inadequate sector reform conditionality |
| IDA | Jul. 1984 | Ethiopia | 40.0 | Telecommunications 10/ | No | Expropriation |
| IDA | Sept. 1984 | Ethiopia | 70.0 | Sixth Education Project | No | Expropriation |
| IDA | Sept. 1984 | Ethiopia | 4.0 | Tech. Assist. for Econ. Mgt. | No | Expropriation |
| IDA | Sept. 1984 | Ethiopia | 22.0 | Ag. Research | No | Expropriation |
| IDB | Nov. 1983 | Chile | 268.0 (IRC) | CODELCO Copper Mining and processing Expansion | No | Inappropriate financial structure. CODELCO rather than the Government should bear the debt service burden |
| ADF | Sept. 1984 | Nepal | 5.2 | Chitwan Valley Irrigation Second Supp. 11/ | Abstain | Unjustified cost overrun |
| AFDB | Oct. 1983 | Guinea | 15.8 | Kouroussa Rural and Industrial Development 12/ | Abstain | Unjustified cost overrun and doubtful economic and financial viability |
| AFDB | Jan. 1984 | Madagascar | 10.1 | Cashew-Nut Agro-Industrial Complex | No | Doubtful economic and financial viability |
| AFDB | Jan. 1984 | Uganda | 2.7 | Equator Road Project Suppl. | Abstain | Unjustified cost overrun |
| AFDB | Jun. 1984 | Ethiopia | 24.5 | Telecommunications 10/ | No | Expropriation |
| AFDF | Oct. 1983 | Guinea | 15.4 | Kouroussa Rural and Industrial Development 12/ | Abstain | Unjustified cost overrun and doubtful economic and financial viability |
| AFDF | Nov. 1983 | Cent. African Republic | 5.1 | Medical School + Teaching Hosp. | Abstain | Unjustified cost overrun |
| AFDF | Nov. 1983 | Ethiopia | 14.6 | Eight Centers Water Supply | No | Expropriation |
| AFDF | Aug. 1984 | Ethiopia | 1.4 | Galana Irrigation Study | No | Expropriation |
| AFDF | Aug. 1984 | Guinea-Bissau | 2.8 | Education I Supp. | Abstain | Unjustified cost overrun |

| Institution | Date | Country | Amount ($ millions) | Project | Vote | Reason |
|---|---|---|---|---|---|---|
| FY 1985 | | | | | | |
| IBRD | Nov. 1984 | Colombia | 130.0 | Petroleum Development | No | Potential displacement of foreign private capital |
| IBRD | Aug. 1985 | Mexico | 150.0 | Low Income Housing | Abstain | Negative real interest rates and budget subsidy |
| IDA | Apr. 1985 | Ethiopia | 30.0 | Drought Recovery Program | No | Expropriation |
| IFC | Feb. 1985 | Brazil | 3.0 equity | COSIGUA Steel Modernization | No | Additional IFC equity investment not necessary, and therefore could displace local private capital |
| IDB | Dec. 1984 | Chile | 48.0 (OC) | Oil and Gas Exploration and Development | No | Potential displacement of foreign private capital |
| IDB | Dec. 1984 | Ecuador | 175.0 (IRC) | Daule-Peripa Multipurpose Dam | No | Doubtful economic viability |
| IDB | Jan. 1985 | Brazil | 44.0 (IRC)<br>14.5 (OC) 13/<br>14.5 (FSO) 13/ | Porto Velho-Rio Branco Road Improvement | Abstain | Doubtful economic viability due to poor natural resource management |
| IDB | Feb. 1985 | Guyana | 28.0 (IRC) 14/ | Industrial Reactivation | No | Inappropriate macro-economic policies |
| ADB | Dec. 1984 | Philippines | 27.9 15/ | Allah River Irrigation | Abstain | Unjustified cost overrun |
| ADB | Jun. 1985 | Indonesia | 1.0 equity (OC) | BAPINDO DFC | No | Added restraints on private sector |
| ADB | Jun. 1985 | Indonesia | 0.4 equity (OC) | Kratama Belindo Steel Fabricating | No | Poor management structure, inefficient import substitution, and no government commitment to divest its (40 percent) interest |
| AFDB | Dec. 1984 | Lesotho | 11.9 | Maseru International Airport | No | Low economic rate of return |
| AFDB | Dec. 1984 | Madagascar | 4.6 | Antalaha Palm Oil Plantation and Mill 16/ | No | Poor soil and excess milling capacity |

| Institution | Date | Country | Amount ($ millions) | Project | Vote | Reason |
|---|---|---|---|---|---|---|
| FY 1985 (cont.) | | | | | | |
| AFDF | Nov. 1984 | Ethiopia | 20.4 | Dairy Rehabilitation and Development | No | Expropriation |
| AFDF | Dec. 1984 | Equatorial Guinea | 2.7 | Cocoa Sector Tech. Ass. | No | Outstanding arrearages owned AFDB |
| AFDF | Dec. 1984 | Madagascar | 5.5 | Antalaha Palm Oil Plantation and Mill 16/ | No | Poor soil and excess milling capacity |
| AFDF | Feb. 1985 | Zaire | 13.2 | SOFIDE Agricultural credit | No | Negative sub-loan interest rates |
| AFDF | Apr. 1985 | Ethiopia | 1.1 | Awash Basin Water Resources Master Plan | No | Expropriation |
| AFDF | Apr. 1985 | Ethiopia | 15.7 | Small-scale Irrigation Project | No | Expropriation |
| AFDF | Sept. 1985 | Somalia | 11.8 | Agricultural Line of Credit for Somali Development Bank | Abstain | Use of seriously overvalued official foreign exchange rate and inappropriate policies on ag. co-ops |
| FY 1986 | | | | | | |
| IBRD | Dec. 1985 | Mauritania | 20.0 | SNIM Iron Ore Mining Rehabilitation | Abstain | Potentially premature due to global overcapacity, and unsound sector tax policy |
| IBRD | Mar. 1986 | China | 75.0 17/ | Third Industrial Credit Project | Abstain | Unsustainable textile export trend given bilateral quota agreements |
| IBRD | Apr. 1986 | Brazil | 155.0 | Agricultural Extension II | Abstain | Obey Amendment (5% decline in soybean oil price) |
| IDA | Mar. 1986 | China | 25.0 17/ | Third Industrial Credit Project | Abstain | Unsustainable textile export trend given bilateral quota agreements |
| IDB | Nov. 1985 | Argentina | 40.0 (IRC) | SIDERCA Seamless Steel Tube and Pipe Expansion | Abstain | Doubtful economic and financial viability due to global overcapacity |

| Institution | Date | Country | Amount ($ millions) | Project | Vote | Reason |
|---|---|---|---|---|---|---|
| FY 1986 (Cont.) | | | | | | |
| IDB | Dec. 1985 | Chile | 130.0 (IRC) | Multisector Global Credit Program III | No | Garn Amendment regarding increased copper production |
| ADB | Dec. 1985 | Pakistan | 42.0 18/ | Pirkoh Gas Development | No | Price controls on "old" gas effectively preclude privatization |
| ADF | Oct. 1985 | Nepal | 14.0 | Cotton Development | No | No government commitment to divest, and non-market determined pricing |
| ADF | Nov. 1985 | Pakistan | 30.0 | Farm-to-Market Roads | Abstain | Inadequate conditionality regarding maintenance |
| ADF | Dec. 1985 | Bangladesh | 15.8 | Chhatak Cement Plant Expansion | Abstain | Key issue of government ownership under U.S.G. review |
| ADF | Dec. 1985 | Bangladesh | 39.0 | Fourth Crop Intensification Program | Abstain | Unsound sector pricing policies, including establishment of a pricing commission |
| ADF | Feb. 1986 | Burma | 35.0 | Edible Oil Development | No | Excessive focus on the public sector, and weak cooperative finances |
| AFDB | Mar. 1986 | Tunisia | 60.5 | Integrated Rural Development | No | Poor project design and negative sub-loan interest rates |

FOOTNOTES

1/ Project withdrawn by management and subsequently cancelled.

2/ U.S. vote vetoed these proposals.

3/ EEC Fund.

4/ Same project.

5/ For IFC's own account.

6/ Swiss Fund. Loan to cabinet-makers cooperative and not guaranteed by the Government. In June the U.S. vetoed the proposed 18-month extension of a disbursement deadline for a previously approved FSO local roads project.

7/ Project temporarily withdrawn by Guyana after U.S. vote vetoed the $10.0 million FSO component.

8/ U.S. abstained on all four votes on the four components of this consolidated cost overrun loan.

9/ Additional IBRD funding for the petroleum project which the U.S. opposed in March, 1984. New IBRD funding was provided as part of a $487.0 million co-financing package. In May the U.S. abstained on the negotiating position, and we also abstained on the final position in July. Both positions were identical.

10/ Same project.

11/ U.S. also abstained on the first cost overrun loan to this project during USFY 1978.

12/ Same project.

13/ Local currency.

14/ U.S. vote killed a $446,000 FSO technical assistance grant. The IDB reacted by including a technical assistance component within the $28.0 million IRC loan.

15/ There was also a $250,000 technical assistance grant.

16/ same project.

17/ same project.

18/ There was also a $250,000 technical assistance grant.

### PROGRAM FOR SUSTAINED GROWTH

Mr. DIXON. The "Baker Plan" unveiled at the IMF/World Bank meeting in Seoul, Korea, in October of last year (and outlined today in your presentation) sets out a new strategy for the international debt problem of third world countries. It is my understanding that the plan is specifically designed to alleviate the heavy debt burdens facing the largest debt countries. Most of these countries are in Latin America, such as Ecuador, Argentina, Mexico, Dominican Republic, Brazil, etc. Since African countries are faced with similar debt service obligations, could you explain where countries like Senegal, Kenya, Cameroon, The Ivory Coast and others fit into your plan?

Secretary BAKER. Our debt initiative is designed to benefit the major debtor countries. However, at the Seoul meeting, I also outlined a proposal for assisting the poorest countries with protracted balance of payments problems, most of which are in Sub-Saharan Africa. This proposal was recently endorsed by the Executive Boards of the IMF and the World Bank. Under the new arrangements, the IMF will provide financing from its new Structural Adjustment Facility in conjunction with World Bank resources, primarily IDA. This financing will be used to support eligible countries to implement economic programs designed to promote growth through macroeconomic policy changes and structural adjustment in a medium-term framework. Economic growth, insofar as it helps countries increase output and hence export earnings, is a key to the alleviation of these countries' debt problems.

Mr. DIXON. Mr. Secretary, I have another question in connection with the "Baker Initiative." The plan emphasizes an acceleration in World Bank's structural adjustment lending or non-project lending activities; policy reform by debtor nations; and significant net new lending from commercial banks. I assume non-project lending would include structural adjustment type programs that support sound policy reforms, especially among least developed countries of which Sub-Saharan African countries constitutes a major target group. Despite the decrease in the relative share of India, China, and other IDA eligible countries, the level of IDA resources available to Africa remain insufficient to carry out traditional projects, and at the same time, meet additional policy based lending requirements proposed by the Administration. There seems to be a slight contradiction between what the Administration is proposing, and the oftentimes, stated policy of supporting loans to desperately poor countries in Africa, which the special facility for Africa is trying to provide. Could you please explain why the Administration again has failed to support the IDA special facility for Africa in the FY 1987 request?

Secretary BAKER. We share your concerns about the plight of the Sub-Saharan African countries and have had efforts underway to help them address their economic problems. As I indicated in my answer to the previous question, the new arrangements for lending in support of adjustment programs recently approved by the IMF and World Bank Boards will primarily benefit the Sub-Saharan African countries.

To ensure that there is adequate funding for IDA's participation, we have secured an agreement in the negotiations on an eighth replenishment that a significant percentage would be used to support adjustment programs. Given current budgetary strictures, we would prefer to concentrate on securing funds for existing U.S. commitments and for the U.S. share of the IDA VIII replenishment.

### ASSISTANCE FOR LOW-INCOME COUNTRIES

Mr. DIXON. Secretary Baker, in view of the grave financial circumstances in Africa, I think we can all applaud your proposal to direct $2.7 billion in IMF Trust Fund reflows to Africa over the next five years. But, as you know even an additional $500 million or so per year from the IMF is not enough to deal with Africa's lack of foreign exchange to generate real economic growth. Africa's problems in recent years are largely the result of external factors (falling terms of trade since 1978, high interest rates, protectionism), but internal factors (poor agriculture planning, overvalued exchange rates, and military spending) have also been important. Yet, experts recently said at a conference in Washington on African debt that even with continued policy adjustments, Africa faces an overall yearly foreign exchange deficit of $6 billion below what would be necessary to finance real growth. About 50 percent of Africa's export earnings are designated for debt service alone. (1) Is the Administration considering recommending a policy similar to that of major donor countries like France, Britain and West Germany that involves "forgiving the debt" of the lowest income countries; and (2) has the Administration considered another strategy for the lowest income countries such as making the debts payable in local currency or refinancing the debts on highly concessional terms (e.g., a 5-year grace period and repayment over 15 years, similar to what private banks have agreed to do for Mexico)?

Secretary **Baker**. The Administration has no plans to forgive the debts of the low income countries. We do not believe that a generalized extension of debt relief is appropriate but that debt problems can best be considered on a case-by-case basis. A sensible approach must take into account the unique situation of the individual country and assure that the debt restructuring extended complements measures the debtor country itself adopts to restore its creditworthiness.

For policy as well as statutory reasons, the Administration does not cancel debts nor permit their repayment in local currency. Such measures would require additional appropriations. Debt relief should not be provided as a substitute for appropriated development assistance but rather extended only to support a country experiencing debt servicing difficulties so that it may restore its balance of payments to a sustainable position and resume paying its debts.

## World Bank Lending for Rural Development

Mr. **Dixon**. Rural development, the largest of the World Bank's poverty oriented sectors, has fallen from 18 percent of Bank lending in FY 1981 to 10.9 percent in FY 1985. The Bank's most recent "Focus on Poverty" report concluded that there is a need to increase the proportion of rural development lending. Would you explain what the Bank's plans are with regard to the future proportion of rural development lending?

Secretary **Baker**. Economic growth and alleviation of poverty are aspects of the same process. Since the early 1970's the Bank has urged special efforts to include low-income countries and low-income people within countries in the process of development. We believe the Bank is strongly committed to this important objective.

Lending to rural development declined as a percentage of total Bank lending from an annual average of 14.4 percent in FY 79-83 to 8.0 percent in FY 1984, before increasing to 10.9 percent in FY 85. However, lending for agriculture is also highly poverty oriented and the percentages for "agriculture and rural development" are about the same, i.e., 27 percent in FY 79-83, 22.4 percent in FY 84 and 26 percent in FY 85. We also expect that FY 86 lending to agriculture and rural development will be higher than the FY 70-83 annual average with preliminary budget projections indicating that a 33 percent share is possible.

## The "Baker Plan"

Mr. **Edwards**. In a nutshell the Baker Plan is a Third World debt initiative. It calls on commercial banks to lend about $20 billion and MDBs to pitch in another $20 billion, if developing countries first adopt market-orineted economic policies. In principle, it's a good idea—provided nations are able to do these things (e.g., dismantle state-owned enterprises, cut subsidies, and liberalize trade), and provided there are institutions capable of encouraging that change. Right now, there aren't, so any new MDB money would only be bailing out banks and washing over Baker's free market approach. All this is very important because Treasury will agree to new replenishments for the MDBs—the level for which we will have "commitments" over the next five years—within the next month. Our big theme has been to use these replenishments, and our negotiated contributions, as leverage over World Bank reforms.

Jim, I want to praise you for working hard to do something about the Third World debt problem, which we all knew never really went away. One of the things I believe many Americans do not fully understand is that debt problems in Latin America means that the U.S. loses business, American workers lose jobs, and the debt crisis can be as much a factor in the U.S. trade deficit as the bulge in imports from Japan.

I'm worried, though, about the World's Bank's role in trying to solve this problem. There are some who might say that the Bank has been the principal cause driving the debt crisis. How would you respond to that?

Secretary **Baker**. The World Bank has certainly not been the principal cause of the debt crisis. The Bank lent money over the years to countries now facing debt servicing difficulties. However, the amounts provided by the Bank in most cases are only a small portion of their total debt. More importantly, the Bank's loans were carefully directed at specific, technically sound projects. Such projects were thoroughly analyzed by the Bank to ensure that the Bank's resources were invested in projects generating economic and financial rates of return sufficient to repay the original loan.

In contrast, much of the commercial bank lending during the later 1970s and early 1980s was excessive, and given to governments for general budget and balance of payments support not conditioned on the implementation of sustainable economic policies. Many countries and their commercial bank creditors are now paying the price for such free spending ways.

The World Bank will be part of the solution to the debt problem as it offers technical and financial assistance in suport of countries' efforts to reform their economies and establish the basis for sustainable growth. By encouraging governments to follow market-oriented policies, by providing advice and expertise on ways to institute such policies, and by financing in part the transitional costs of such reforms, the Bank can play a crucial role in not only resolving debt problems but in modifying the economic orientation of developing countries.

Mr. **Edwards**. The only reason I ask is that we really don't know the Bank as anything more than a way of fueling inefficient bureaucracies, paying for the costs of subsidized industries, and either displacing foreign private investment of prohibiting the development of private companies in developing countries. Along those lines how much money would you say that the Bank has contributed to help privatize government enterprises in developing countries? How much would you say the Bank has put into state-owned enterprises?

Secretary **Baker**. Although the Bank has not directly financed privatization of government enterprises in borrowing countries, it has encouraged privatization by various means. Many structural adjustment, sector and project loans have required a reduction in the role of government enterprises, increased profitability of public sector enterprises, reduced subsidies and have provided technical assistance to help the borrowing countries in their privatization efforts. The exact dollar amount would be difficult to calculate since the Bank's efforts in this area have been made in the context of loans for programs that include privatization as one goal among others.

Our survey of loans made by IBRD and IDA over the period April 1, 1985 to September 30, 1985 (the second half of FY85) showed all 149 loans had public sector executing agencies but 6 also had private sector entities directly involved in project execution. In 41 cases the public sector was clearly a beneficiary and in 57 the private sector benefitted. This indicates that while the Bank continues to lend to governments and their public sector entities the Bank recognizes private sector has an important role to play in development.

## IBRD CAPACITY TO PROMOTE FREE MARKET REFORMS

Mr. **Edwards**. Does the World Bank have a general policy on negotiating the terms and conditions of its loans? How good has the Bank been at encouraging free market reforms?

Secretary **Baker**. No, the World Bank does not have a general policy on negotiating the terms and conditions of its loans. Please see the attached table showing the ranges of current lending terms of IBRD, IDA, and IFC. Terms of individual loans are set within these ranges to reflect country and sector factors.

The Bank has been encouraging free market reforms through its program of Structural Adjustment Lending (SAL) and its sector lending program. There have been reforms to assist in the freeing of agricultural prices to market levels in SALs to Thailand, Philippines, Togo, Jamaica, Turkey, Cote d'Ivoire, Korea, Mauritius, and Malawi among others.

Phased elimination of quantitative restrictions is part of the SAL programs for Jamaica, Korea, Cote d'Ivoire, Turkey, and the Philippines. Tariff reforms, comprising increasing uniformity and decreasing average levels of tariffs, are part of the SAL programs for Kenya, Thailand, Turkey, Philippines, and Cote d'Ivoire, among others. There have been tax reforms to reduce the bias against exports in Thailand and the Philippines. In Mauritius, interest rate ceilings have been removed to stimulate private savings, and the SAL for Turkey sought to liberalize interest rates on deposits as part of the measures to improve performance of capital markets.

Market liberalization measures are also included in sector loans. We have recently approved an Agricultural Sector Loan for Argentina which supports the freeing of tariffs on fertilizer, and incorporates as a condition for the second tranche of the loan a reduction of the export tax on agricultural commodities to a level not to exceed 70 percent of the rates in force on May, 1985 or other such limits as may be jointly agreed. Under the Ecuador Industrial Finance Project free market reforms are supported by reducing quantitative restrictions, reducing tariff levels on manufactured products, and reducing tariff dispersion. It further supports interest rates which are market based or positive in real terms to mobilize savings and encourage efficient resource allocation.

Other project lending to these countries also contains conditionality. Agricultural projects and energy projects, for example, often support pricing policies which either free agricultural prices or raise energy tariffs to meet long run marginal costs and reduce consumer subsidies. The World Bank often includes necessary project related sector reforms as conditions of effectiveness to its loans.

Mr. **Edwards**. Have trade policies in developing nations ever been considered a criteria for evaluating loan applications? Would we ever see, for example, a loan denied to a country based on the fact it was engaged in what the U.S. might consider unfair trade practices? Does the United States have any leverage to respond to this situation? How often are we outvoted on decisions such as these?

Secretary **Baker**. Trade policies are regarded by MDB managements and by this Administration as one of the most significant components of a borrowing nation's macro-economic policies. Accordingly, we examine trade policies carefully, especially for export development, industry sector, and structural adjustment loans. The overall thrust of MDB policy in this area is strongly in favor of reduced trade barriers, realistic foreign exchange rates, and the promotion of open, competitive, private sector economic systems.

We have not yet opposed any MDB loans solely due to unfair trade practices, as the MDBs generally avoid such situations. However, we are aware of the potential importance of this issue, and we will not hesitate to oppose MDB projects for that reason if appropriate.

## General Capital Increase

Mr. **Edwards**. Jim, on page 3 of your statement, you said quite bluntly that you are prepared to consider a General Capital Increase for the World Bank. I was planning on asking you, before I saw that, when you were planning to ask for that. Should we be preparing ourselves for this soon?

Secretary **Baker**. We have indicated to the other shareholders of the World Bank that we would consider a general increase in the Bank's capital if and when an increase in quality loan demand makes such an increase necessary. The Bank now has sufficient resources to meet current loan demand. It is not possible to project with any accuracy future loan demand, because it depends primarily on the willingness of debtor countries to design, adopt, and implement sound programs of economic reform that the Bank can support. Assuming a significant adjustment with growth by heavily indebted countries, I doubt a capital increase would be needed before FY 88.

Mr. **Edwards**. Let me ask you a few hypothetical questions. Suppose the Congress did approve a new General Capital Increase during the budget deficit—I told you this would be hypothetical. What would you expect the developing nations, especially Latin America and Africa, to do with the money?

Secretary **Baker**. We would expect any capital increase in the Bank to be used primarily to finance the Bank's expanded policy-based lending operations. These loans are designed to provide financial support to countries' economic reform efforts. These reforms aim at promoting trade liberalization, deregulation of domestic economic decision making, rationalization and divestiture of public sector enterprises, and in general greater reliance on market dynamics. Implementation of such reforms is crucial to establishing the basis for sustainable growth and the conditions necessary to restore countries' creditworthiness.

Mr. **Edwards**. Would you expect the World Bank to help encourage these kinds of activities? Would you expect at that time that the major commercial banks would once again start lending to the developing countries?

Secretary **Baker**. The Bank is making a major effort to encourage implementation of economic reform programs in its borrowing countries. This involves an extension and intensification of its technical assistance and advice and an expansion in its so-called Structural Adjustment and Sectoral Adjustment Lending Program. These efforts of microeconomic reform will complement macroeconomic policy adjustment supported by IMF stand-by arrangements. We fully expect commercial banks to extend financial support to countries undertaking sound adjustment with growth efforts supported by the bank and the Fund. As adjustment proceeds and creditworthinees is restored, it would be in the commercial bank's interests to return to fully voluntary lending to the these countries.

Mr. **Edwards**. Quite frankly, I can see only two basic reasons why the major commercial banks would start lending again. One is that the economic climate in developing nations would have somehow taken the difficult steps necessary beforehand.

The other is that commercial banks somehow expect that through the MDBs, there will be some kind of government guarantee for them. I'm worried that if that is the case, then we will be transferring the risk of new lending from the commercial banks to the MDBs and our central banks. Is it our intention to create that kind of government guarantee through a capital increase for the Bank?

If so, I think we're making a terrible mistake. You don't have to remind me about our banking problems—I'm from Oklahoma and we have a few problems out there. But if the United States wants to bail out the banks, why don't we just make the painful steps and ask for that up front, instead of laundering money through the World Bank and inefficient third world governments?

Secretary BAKER. The "Program for Sustained Growth" focuses attention on the need for structural improvements and growth in the debtor countries as important elements in resolving their debt problems. As I stated in my testimony, "solving the debt problem . . . requires recognition by the debtor countries themselves of the need to adopt growth-oriented economic policies." It is in the banks' own interest to increase lending in support of the adoption of growth oriented economic policies by the debtor nations. New lending can help to improve the quality of outstanding credits if reforms improve the prospects for longer-term growth.

We are not bailing out the banks, nor do we support bank demand for assurance of guarantees or preferred creditor status. Banks are being asked to increase their exposure to the major debtors by a modest 2.5-3%, compared to an increase in World Bank exposure of 20%/year.

### ACTIONS TO LEVERAGE THE "BAKER PLAN"

Mr. EDWARDS. So far, Treasury has been willing to use its leverage to force the World Bank to insist on a free market strategy. We have an excellent chance to do so, with negotiations on a General Capital Increase and other MDB replenishments. Our June 28, 1985 letter asked for exactly that: no U.S. participation until we see reforms in concessions lending and increased private sector emphasis. Jim, where is there greater emphasis on the free market system and private sector development, and greater financial participation by local private sectors in Bank programs?

Secretary BAKER. It is clear that outward-oriented government policies and those which provide the incentives for a free market which rewards hard work and legitimate risk are those most likely to produce development success. It is important therefore that all of the multilateral development banks, and not just the IFC and IIC, promote market and private sector forces. In this context, I am encouraged by international consensus which has emerged on the critical importance of MDB support for reducing structural rigidities, strengthening incentives for the private sector, reducing the size of government, and improving the investment environment.

Mr. EDWARDS. The 1982 MDB Assessment, which you refer to in your statement, recommended hardening terms for countries receiving loans from MDB's and reducing U.S. contributions to the soft loan windows in real terms? Does this budget request reflect these objectives?

Secretary BAKER. The United States has significantly reduced the level of U.S. contributions to the concessional windows of the MDBs in real terms. We remain strongly committed however, to multilateral efforts to provide effective support for the development efforts of the less creditworthy low-income countries. Consistent with the 1982 MDB Assessment, our approach to all of the MDBs, including the concessional windows, is designed to encourage adherence to free and open markets, emphasis on the private sector, minimal government involvement, and assistance to the needy who are willing to help themselves.

Future U.S. participation in MDB concessional windows will be contingent on the extent to which these institutions are judged to serve overall USG interests. We are working hard to ensure resources are used in a growth context which supports and encourages appropriate economic policy. In this context, I would like to note that we are very encouraged by the World Bank's support for using IDA resources—together with the IMF's Structural Adjustment Facility—to support comprehensive growth-oriented programs in low-income countries.

### REDUCE INTEREST RATE ON FOREIGN DEBT

Mr. LEWIS. Last week, the World Bank Vice President for External Relations, Mr. Botafogo, of Brazil, spoke to the Group of 24 endorsing the idea that debtor nations should reduce, unilaterally, the interest rate on their debts to 5%. Is this now official World Bank policy, and would this apply to World Bank debt?

Secretary BAKER. It is not World Bank policy to urge a unilateral reduction in interest rates. This applies to its own loans, as well as to other loans to heavily indebted developing countries. Mr. Botafogo, in his remarks to the G-24, was attempting to outline various elements affecting the resolution of countries' debt problems. The thrust of his comments, which may have been garbled in subsequent press reporting, was that a fall in interest rates (depending on its magnitude) could have significant effects. As you know, interest rates have in fact fallen substantially, and this is indeed benefitting debtors directly through lower debt service payments and indirectly as world economic activity increases.

## COUNTRY ARREARAGES WITH THE IMF

Mr. LEWIS. Is it not true that IBRD had its first default last year? Is it not true that there are now 9 countries in actual default to the IMF? What steps have these institutions taken to provide for losses?

Secretary BAKER. Borrowers from the World Bank are not considered in default, they can only be in arrears. When payments are more than 90 days overdue the Bank stops disbursements on existing loans and does not approve new loans. Borrowing countries have been in arrears in the past, and the Bank has stopped disbursements and new loans until the arrears were paid off.

In recent years, a number of countries have experienced difficulties in meeting their IMF obligations, resulting in large and growing arrears to the IMF. As a result, four countries have been declared ineligible to use Fund resources. The IMF has taken a number of steps to deal with the growing arrears problem. The Fund has decided not to include in current income the charges (interest) receivable from members that are overdue by six months or more in meeting their obligations. The Fund raised its target level of income from 3 to 5 percent of reserves in order to strengthen the financial integrity of the institution.

The Fund accelerated the timetable for reaching a decision to formally declare a member ineligible to use IMF resources. There is public notification of the ineligibility declaration. The Fund has instituted a system of special charges for members in arrears. Charges on IMF financing have been raised. Furthermore, in the near future, the IMF will consider establishing reserves against potential loan losses.

In relative terms the arrears of Nicaragua are small and the large levels of World Bank reserves will more than cover any such losses.

## IBRD LENDING FOR STATE-OWNED ENTERPRISES

Mr. LEWIS. Why is it that the percentage of World Bank lending of state-owned enterprises has increased since the Baker plan was announced? I am particularly concerned about the Brazilian loans to the state-owned power sector, to the state-owned development banks and to the North East Rural Development (NERD) project which finances the salaries of civil servants.

Secretary BAKER. We were not aware that lending for state-owned enterprises had increased significantly since the announcement of the Program for Sustained Growth. Our survey of World Bank loans approved over the period April 1, 1985-September 30, 1985 (the second half of FY 85) showed that all of the 149 loans had public sector executing agencies but 6 had private sector entities involved in project execution. Of these loans in 57 the private sector benefitted, but even in others the private sector was a general or indirect beneficiary. We have not seen a significant shift in this pattern. However, there are more structural adjustment and sector loans being made since the announcement of the Program for Sustained Growth.

By their nature these loans are made to the governments of the borrowing countries but many of these loans are directly aimed at reducing the role of the government and emphasizing the private sector. You are concerned about the loan to the power sector in Brazil, but there the Bank required tariff increases, thereby reducing the burden on the government finances. The Bank also lent to state-owned development banks and is financing a series of rural development projects in Northeast Brazil. However, most, if not all of the beneficiaries will be in the private sector.

## POLICY REFORM

Mr. LEWIS. Can you give me an example of a firm case of privatization achieved by the Bank since the Baker plan was announced? Can you give me examples in high debt countries where the Bank has successfully achieved liberalization of markets or tax reform since the Baker plan was announced?

Secretary BAKER. Under the Niger Structural Adjustment Program of February 1986, three parastatals will be transferred to the private sector (SONITAN, SNCP, AND CMAN) and the management of three hotels will be transferred to the private sector.

Since the "Program for Sustained Growth" was announced, there has also been several cases of market liberalization in high debt countries. For example, we have recently approved an Agricultural Sector Loan to Argentina, which supports the freeing of tariffs on fertilizer, and incorporates as a condition for the second tranche of the loan a reduction of the export tax on agricultural commodities to a level not to exceed 70 percent of the rates in force on May 1, 1985 or other such levels as may be jointly agreed. The Ecuador Industrial Finance Project on March 1986 also supports the liberalization of markets by reducing quantitative import restrictions, reducing tariff levels on manufactured products, and reducing tariff dispersion. It further supports interest rates which are market based on positive in real terms to mobilize savings and encourage efficient resource allocation.

### IBRD LOAN REFUSED BY A CITY IN BRAZIL

Mr. LEWIS. I am submitting for the record a copy of a recent Los Angeles Times article about a city in Brazil which refused a World Bank loan. This is a good example of the Bank being more interested in making a loan rather than insuring that there is a real need before creating more indebtedness. What is being done to convince The Bank that making loans is not necessarily the same thing as promoting development?

Secretary BAKER. The World Bank is reviewing the details of the loan to Brazil in question and will be getting back to us with more information about it in the near future.

Let me say in general however, The Bank does not push loans on any country. Rather, the government of the borrowing countries must first make a request for a loan to the Bank to support the priority projects in their development plans. The loan in question, was part of The Recife Metropolitan Region Development Project, which included a loan of $123.9 from the Bank, and another $225.73 million of Brazilian government funds from the federal, state, and municipal levels.

The needs to be met by this loan are impressive; specifically, it would upgrade 56 low income settlements or neighborhoods; construct housing and provision of basic services for commercial centers, industrial workshops and warehouses; technical assistance and training to small and informal sector enterprises and cooperatives, and improved labor market information services for employment creation and income improvement will also be provided under the project. The total project is intended to serve an estimated 200,000 people with incomes below the relative urban poverty level in the country.

According to the Los Angeles Times article, one village of 17,000 people turned down a loan of $150,000. This was just one of many municipalities which accepted the project. In fact, one could say this example only illustrates that the mechanisms for determining and reviewing which municipalities will participate under this loan were effectively working.

### BRAZILIAN TOWN SHATTERS PRECEDENT—VILLAGE DOES UNTHINKABLE, REJECTS WORLD BANK LOAN

(By Bruce Handler)

Itapissuma, Brazil—This fishing village on Brazil's northeast coast raised eyebrows and gained national attention recently by turning down a $150,000 foreign loan.

But Itapissuma shattered the precedent by a show of hands at a village meeting. The villagers decided that their local officials did not need the modern-management training the money was intended for, and that if they did take the loan, they might not be able to pay it back.

"Everybody thought we were crazy to turn down the dollars," said Maria da Conceicao Albuquerque, Itapissuma's education secretary and the ranking authority on duty when a reporter visited the palm-fringed village of 17,000 people, 1,580 miles northeast of Rio de Janeiro.

"But here in Itapissuma, we prefer to get by with our own resources."

The $150,000 was part of a World Bank-backed $347-million loan package for street construction, slum improvement, basic sanitation and overall development in this northeastern area where abject poverty exists alongside modern progress.

Of the total package, $4 million was allocated in the area for "training of municipal officials in modern management principles." Itapissuma was offered the $150,000 by the regional foundation for that purpose.

"If you take a loan you really don't need, you assume debt for no good reason. You have to pay the money back with interest. That means higher taxes. We didn't want that."

Oswaldo Vieira, the Brazilian who is the head of the regional foundation in charge of disbursing the money, said: "Itapissuma is a strange case. Those people are very stubborn. We offered a five-year grace period and repayment at less than the domestic rate of inflation, but they wouldn't take it."

He added that the village, in view of the usually unquestioned acceptance of foreign loans in Brazil, was "going the wrong way down a one-way street." If Itapissuma insisted on saying no to the $150,000, Vieira said, the foundation would offer the money elsewhere and some neighboring town certainly would snap it up.

The official said he asked Itapissuma's officials for assurances that the villagers were not "misinformed" about the loan.

"We talked to all sorts of different local groups," Albuquerque said, "fishermen, laborers, teachers, priests, expectant mothers at our pregnancy center and even members of the opposition political party.

"We explained about the loan. We held a town meeting in the central plaza and asked for a show of hands. Everybody voted no."

The national news magazine Afinal marveled at the villagers' decision: "Dollars? No, sir. Itapissuma decides it doesn't need the World Bank."

Albuquerque pointed to a sign near the local fishing pier, which proclaimed in Portuguese: "Itapissuma City Government. Works carried out with municipal resources backed by the people of Itapissuma."

She said that since the community's incorporation in 1982 it had built, on its own, a city hall, a library, a police station, a pregnancy center and two schools.

"We used local building materials, and the people pitched in with volunteer labor," she said. "There was no reason for us to get mixed up with other people's money—and all those obligations."

Secretary BAKER. The World Bank has given us an update on the loan to Itapissuma, Brazil. According to the World Bank staff, in the municipal elections of Itapissuma held in October-November 1985, the mayor was elected from a different political party than the governor. The mayor decided to play politics and oppose the World Bank project since it was viewed as a state-sponsored project. Thus the opposition to the project was politically motivated rather than economically motivated. Furthermore after seeing the implications and benefits of the project, Itapissuma is now back in the project. They have taken the World Bank loan.

## POPULATION

Mr. PORTER. Secretary Baker, can you explain why the United States has been the key country in opposing family planning health projects funded by the World Bank in Bangladesh when the South Asia people at the State Department list "a reduction in fertility" as the first objective of our $155 million aid program there?

Secretary BAKER. It is true that reduction in fertility is a major objective of our aid program in Bangladesh. We are also concerned about the application of family planning standards to programs funded by the World Bank in Bangladesh.

In the Bangladesh Third Population and Family Health Project, the services to be performed in the clinics to be constructed by this project were not entirely clear. It might have been possible that a substantial number of abortions would have been performed in the family planning/health clinics and this was a matter of great concern to the United States. For this reason, we opposed the loan.

Mr. PORTER. Are there plans to disapprove of an upcoming loan for South Korea for similiar reasons?

Secretary BAKER. No new loan for population in South Korea is being considered by the Board in the near future. An amendment to a Korea Population Project was approved by the U.S. Director in February 1986 since it would extend the project and meet objectives basically agreed upon previously in the original loan of 1979.

## NICARAGUA

Mr. PORTER. Hasn't Nicaragua totally suspended payments on its debts to the MDBs? When was the last MDB loan approved for Nicaragua? Are there any plans at the bank staff level for future loans to Nicaragua? Are there any other nations who have flatly refused to pay back their MDB loans?

Secretary BAKER. No, Nicaragua has not totally suspended its payments to the MDBs. As of March 28, 1986, Nicaragua is current on its payments to the Inter-

American Development Bank (IDB). In the World Bank, however, Nicaragua is in arrears and the oldest overdue service payment dates back to May 1983. The last MDB loan was an IDB loan to Nicaragua in September 1983 for the fishing industry. (The United States opposed this loan but it was approved by the Board.) The World Bank has only one loan left in its pipeline for Nicaragua but it has been postponed indefinitely and reporting on it will be discontinued. The IDB also has some loans in its pipeline but we do not expect them to come forward in the foreseeable future. Various countries are in arrears to the MDBs but none have declared they will refuse to pay back the banks eventually. Even Peru has indicated it will pay back its debts to the World Bank and the Inter-American Development Bank.

## LIMITS ON DEBT SERVICE PAYMENTS BY PERU

Mr. **PORTER**. The new Peruvian President, Alan Garcia, told his people that no more than 20% of his country's export earnings would go to service their debt.

Is there any indication of this policy changing?

Have any other nations, besides Cuba, expressed support for this idea?

Secretary **BAKER**. In his inaugural address on July 28, 1985, President Garcia stated that Peru will limit its external debt service payments for the next 12 months to 10% of export earnings. The GOP has maintained this position, leading to a substantial build-up of external arrears to commercial banks, official bilateral creditors and the IMF. This policy has considerably reduced Peru's access to external resources and is damaging its prospects for long-term growth. We do not know what Peru's policy on debt will be after July 1986. We hope that Peru will take a more cooperative approach with its international creditors which would be beneficial to all parties.

Although several countries have indicated that external debt service payments should take into consideration the level of export earnings, none of the other Latin American nations, except Cuba, has expressed support for Peru's policies. Nigeria, however, has imposed a ceiling on its 1986 debt service payments of 30% of export earnings. If this policy is pursued, Nigeria's arrears to external creditors would substantially increase.

## SAUDI ARABIA

Mr. **PORTER**. Saudi Arabia was recently granted its own seat on the World Bank Board. What did the United States get for this move ?

Secretary **BAKER**. Saudi Arabia's share of subscribed shares is sufficient to elect its own Executive Director. (The Saudis also have a separate seat in the International Monetary Fund.) If Saudi Arabia elected its own Executive Director, and if the number of Executive Directors was not increased, one of the existing groups of members presently represented by an Executive Director—either in Sub Sahara Africa or Latin America—would have been adversely affected.

The proposal allowing Saudi Arabia to obtain an Executive Director was therefore related to an increase in the number of elected Executive Directors from 16 to 17. This avoided upsetting existing geographical representation. The proposal was approved without objection by all Executive Directors. There were no pre-conditions. We fully expect Saudi Arabia to accept a constructive role in Bank operations commensurate with the responsibilities conferred by a separate seat on the Board.

## POLAND MEMBERSHIP IN IBRD

Mr. **PORTER**. Recently Poland has applied for membership in the World Bank. What kind of concessions are we seeking before our consideration of their admission? Are human rights concerns on the top of our list in regard to this application?

Secretary **BAKER**. The Executive Board of the World Bank is expected to consider Poland's application for membership on May 20. Adoption of a resolution for membership must receive the approval of a majority of the votes cast. the United States' position on Poland's application is being carefully considered.

## SPECIAL FACILITY FOR AFRICA

Mr. **PORTER**. Last year, the Congress approved over $70 million to be given to a "Special Facility for Southern Africa" inside the World Bank. A number of Bank people were confused that due to the Congressional and Gramm-Rudman cutbacks, we were now behind on our payments to the World Bank but were now contibuting to this Special Facility. Do you share this concern?

Secretary **BAKER**. We trust that there will be no basis for such concerns in the future. As I indicated in my response to another question, the new arrangements for lending in support of adjustment programs recently approved by the IMF and World Bank boards will primarily benefit the Sub-Saharan African countries. To ensure that there is adequate funding for IDA's participation, we have secured an agreement in the negotiations for an eighth replenishment that a significant percentage would be used to support adjustment programs. Given current budgetary structures and the state of play with respect to our other obligations to the World Bank and other international financial institutions, we are concentrating on securing funds to meet these obligations and for the U.S. share of the IDA VIII replenishment.

### MULTILATERAL INVESTMENT GUARANTEE AGENCY [MIGA]

Mr. PORTER. Secretary Baker, you of all people are painfully aware of the political problems of starting a new program in this year of all years. I understand that we have a request to provide $22 million for the new Multilateral Investment Guarantee Agency (MIGA) I fully support your drive to replace debt with foreign held equity as one of the best ways to foster continued investment in the third world, but how can I explain to my constituents that we need yet another spending program this year?

Secretary BAKER. The Administration believes the MIGA will be a valuable new multilateral institution, uniquely placed to advance our policies toward LDC development as well as our own economic interests. The potential returns on the $22 million budget outlay in our view can be substantial. For example, as the MIGA stimulates private investment flows to LDCs over time, this additional capital can substitute for scarce official flows from both governments and the multilateral development institutions. The MIGA will also generally improve standards for investment protection and promote LDC policy reforms. This will encourage a safer environment for U.S. investment—an objective that is in our interest as the largest international investor.

Mr. PORTER. Besides its multilateral control, how will MIGA differ from our own equity guarantee agency, the Overseas Private Investment Corporation (OPIC) in operation?

Secretary BAKER. The MIGA will differ form OPIC because of its strong mandate to promote LCD investment policy reform. Specifically, the MIGA will provide advice and technical assistance to developing member countries with the objective of improving investment conditions and removing impediments to investment flows. The Agency is also directed to promote and facilitate the conclusion of investment protection treaties among its members. Further, it will conclude bilateral and multilateral agreements with its members to assure that the investments guaranteed by it will receive treatment at least as favorable as that accorded by the member concerned to the most favored state or investment guarantee agency.

By encouraging reforms which reduce or remove restrictions on investment flows, the MIGA will stimulate the flow of equity capital to developing countries. The non-debt nature of foreign direct investment flows is particularly important to LDCs at this time. Direct investment provides needed capital, and the longer-run benefits of substituting this source of capital for other types of financing either from official sources or from commercial banks—can be substantial. Direct investment expands the resource base of the recipient developing country, contributes to the domestic productive capacity, creates new employment opportunities and provides needed managerial and technical skills.

Mr. PORTER. I understand that Italy and the Netherlands have already signed on to MIGA. When will the United States?

Secretary BAKER. The Administration would envision signing the MIGA Convention and attending the preparatory conference following further consultations with the Congress. The Administration would not, of course, commit the United States to join the MIGA until after authorization and appropriation of funds by the Congress.

### THE BAKER PLAN

Mr. PORTER. I was impressed by the imagination an initiative you took in outlining the "Program for Sustained Growth", otherwise known as the "Baker Plan" up here. As I understand your plan is a three part deal in which the debtor nations reform their economic policies, the U.S. and other donors increase their MDB lending and commercial banks increase their lending. I read in the paper the other day that there is considerable resistance among the commercial banks to increase their lending—is that so?

Secretary BAKER. National banking groups in all major creditor countries—Canada, France, Germany, Italy, Japan, the Netherlands, Sweden, Saudi Arabia, the U.K., as well as the U.S.—have endorsed the debt initiative with its emphasis on growth-oriented economic reform in the debtor nations and have pledged to support it through new lending. As these nations implement credible reforms, have IMF programs in place where appropriate, and secure additional World Bank financing, additional commercial bank lending will be made available.

We estimate a need for $20 billion in net new lending by the commercial banks in support of these growth-oriented policies by the debtor nations over the next three years. We believe this new lending, in addition to that provided by the international financial institutions, is sufficient within a framework of cooperative efforts, to provide sustainable growth of five percent for the major debtors within this period.

### MONEY SPENT IN THE U.S.

Mr. **PORTER**. I understand that most of World Bank money is actually spent in the developed world for equipment and planning for projects in developing countries. I also understand that some countries get back far more in procurement dollars than the United States. Is that true and could you provide the Committee with some figures on World Bank procurement relative to the share we pay in?

Secretary **BAKER**. A very substantial part of World Bank money is, in fact, spend in developed member countries of the Bank. These funds include monies spent for equipment, consultant services and civil works. As of June 30, 1984, cumulative disbursements to U.S. sources of procurement and U.S. paid-in subscriptions and contributions to the Bank were roughly in balance at the level of $11.0 billion. Some other developed member countries have gotten back an amount in the form of procurement that is larger than their paid-in subscriptions and contributions.

The following report on progress of the Multilateral Development Banks have made in implementing environmental reform measures is submitted for the record by the U.S. Department of the Treasury, in compliance with requirement in section 540, subsections (b) and (d) of the FAA.

DEPARTMENT OF THE TREASURY
WASHINGTON

ASSISTANT SECRETARY

April 30, 1986

Dear Mr. Chairman:

On behalf of the Secretary of the Treasury, I am submitting this report in accordance with the requirements in Section 540, Subsections (b) and (d) of the Foreign Assistance and Related Programs Act, 1986 (Public Law 99-190), referred to hereafter as the Act.

Subsection (b) requires the Secretary to report to the Committee by March 31, 1986 on progress the Multilateral Development Banks have made in implementing the environmental reform measures described in Section 540(a), Clauses (1) through (4) of the Act. Subsection (d) specifies that the report should include discussion of progress in the International Bank for Reconstruction and Development toward adding environmentally trained professionals or developing and implementing alternative plans for environmental staffing in each of the Bank's six regional offices to review projects for prospective ecological impacts.

We regret the delay in submitting the report.

After reviewing the provisions of the legislation, this report will discuss, bank by bank, how we are progressing with regard to Clauses (1) through (3). It will then describe progress with regard to strengthening the environmental aspects of the activities of the Economic Development Institute of the World Bank, the subject of Clause (4). Finally, we would like to offer our thinking with regard to how to proceed in the coming months.

## Provisions of Legislation

Clause (1) requires the Secretary of the Treasury to instruct the Executive Directors representing the United States in the multilateral development banks to vigorously promote a commitment of these institutions to add or strengthen professionally trained staff to undertake environmental review of projects; or to develop management plans to substantially increase the environmentally trained staff engaged in review of the ecological impacts of prospective projects. Section 540, Subsection (d) of the Act elaborated on this requirement with respect to the World Bank as noted above.

Clause (2) (A) requires the Secretary of the Treasury to instruct U.S. Directors in the multilateral development banks to promote changes in these institutions that will encourage staff and borrower countries to actively and regularly involve environmental and health ministers, or comparable representatives, in the preparation of environmentally sensitive projects and in bank-supported country program planning and strategy sessions.

Clause (2) (B) requires the Secretary of the Treasury to instruct U.S. Directors in the multilateral development banks to promote changes in these institutions that will encourage staff and borrower countries to actively and regularly use the resources of available nongovernmental conservation and indigenous peoples' organizations, and consistent with international procurement policies, in the preparation of environmentally sensitive projects and in bank-supported country program planning and strategy sessions.

Clause (3) requires the Secretary of the Treasury to instruct U.S. Directors in the multilateral development banks to vigorously promote a commitment of these institutions to increase the proportion of their lending programs supporting environmentally beneficial projects and project components, resource rehabilitation projects and project components, protection of indigenous peoples, and appropriate or light capital technology projects.

Clause (4) requires the Secretary of the Treasury to instruct the U.S. Director at the World Bank to vigorously promote the establishment within the World Bank's Economic Development Institute of a component which provides training in environmental and natural resource planning and program development.

## The World Bank

The Acting U.S. Executive Director of the World Bank has requested that the subject of the Bank's procedures in connection with the environmental aspects of the Bank's activities be discussed during the consideration of the operating and administrative budget for the Bank's Fiscal Year 1987. He specified that the discussion should include the staffing and organizational arrangements which the Bank employs in addressing these aspects.

In anticipation of Board consideration, the Acting U.S. Executive Director has held informal discussions with Bank Management and will be holding discussions with other Directors on the specific points raised in the legislation.

On January 15, our Director briefed Bank Management on the suggestions in the Act. He emphasized the need to review carefully the several suggestions on organization and staffing which have been put forward, especially the suggestion related to the addition of staff in each of the Bank's six regional offices to advise on environmental matters.

He suggested that the Bank consider favorably the issuance of a requirement that Bank project staff systematically consult with ministries or agencies in borrowing countries having responsibilities for environment and health. To that end, he proposed that each appraisal report issued to the Board of Directors on a Bank project include a specific notation with regard to whether such ministries or agencies were consulted. In that way, the Directors would be able to ask staff for the views of these elements of the borrower governments either during or prior to Board consideration.

Similarly, our Director suggested that the Bank consider favorably the issuance of a requirement that Bank project staff systematically consult with available nongovernmental conservation and indigeneous peoples' organizations. He stressed that he was not suggesting any modification of the Bank's normal procurement procedures for consultants or suppliers. Our Director proposed that each appraisal report issued to the Board of Directors on a Bank project include a specific notation with regard to whether such organizations were consulted. Directors would then be able to ask the Bank staff about the views of such groups.

The Acting U.S. Director held a follow-up meeting with Bank Management on February 27. His clear impression is that the Bank is giving favorable consideration to the U.S. suggestions and, specifically, that some staffing proposals will be recommended to the Board on April 30. Bank Management stressed that any staffing proposals had to be considered in the light of the existing firm constraints on overall Bank staff levels.

Bank Management also briefed our Director on an extensive staff review of the "Economics of Natural Resource Use" which has been underway since November 1985. As planned, the review should represent a searching re-examination of how the Bank designs and implements projects in the environmentally sensitive sectors, i.e., agriculture, energy and road construction. Bank Management anticipated that the results of the review might include a Bank policy statement and a series of guidelines for Bank staff to use in the performance of their duties.

In response to a question from our Director, Bank Management acknowledged that staffing and organizational changes were other possible results. The review was not expected to be completed until early in Fiscal Year 1988, but some results could be expected earlier, and would be implemented as the review is carried out.

Our Director commented that the review should be carried out with the 1982 tribal peoples policy in mind. Experience had demonstrated that the use of natural resources in some Bank projects had an effect on tribal peoples, as well as on the prospects for sustainable development.

Bank Management informed our Director that the Directors representing the United Kingdom, the Netherlands and Australia had also shown an active interest in the review.

At the request of the Director representing the Nordic countries, our Acting Director briefed a representative of the Nordic constituency on February 4. He explained the suggestions in the Act and our Director's plans for carrying out his instructions. The representative of the Nordic countries indicated his broad support for the suggestions.

In preparation for the April 30 Board meeting, the Acting U.S. Director has initiated a series of briefings for other Directors on the suggestions put forward in the Act and on our intentions in the Board meeting. We also plan to discuss our intentions with appropriate officials in other donor countries through U.S. embassies.

Separately, we have taken some steps to promote environmentally beneficial projects. Before describing our actions and plans, we should stress that we believe this suggestion needs to be implemented with deliberation. It would be all too easy -- and largely unproductive -- simply to urge the Bank to increase its proportion of lending for environmentally beneficial projects. We would soon be inundated with descriptions of projects that, without further investigation, would appear to be beneficial. But we would have no information to judge whether the banks have thoughtfully re-evaluated their lending programs to enlarge their portfolio of environmentally beneficial projects.

Our approach to implementing the legislative requirement to promote environmentally beneficial projects is more deliberate, and will take more time. However, we believe it will yield more certain results. We plan to select specific types of environmentally beneficial projects and identify opportunities for such projects. Then, we plan to solicit Bank views on specific projects in specific countries and evaluate the responses. Perhaps, some perceived opportunities may prove infeasible.

At the end of this process, we should have examined a sufficient number of possible projects to reach relatively firm conclusions with regard to whether opportunities are being systematically assessed by the Bank; and if not, why not. In the process, we may also find that specific projects, which might otherwise not have taken place, are planned and implemented.

The first area where we believe additional environmentally beneficial projects are possible is for the protection and sustainable use of tropical forests. Here, we are leaning heavily upon the work that was assembled and recently published by the World Resources Institute. The Institute identified numerous project ideas in 56 developing countries, including suggestions for fuelwood and agroforestry proposals, upland watershed management, industrial forestry, forest conservation and institutional strengthening. The very tentative investment estimates were $5.3 billion over five years, shared among all donors as well as recipient governments. A fair share of this investment program allocated to the World Bank (and the regional development banks) appears to be financially realistic and feasible.

On March 5, Secretary of the Treasury James A. Baker III wrote to World Bank President A. W. Clausen, Jr. and endorsed the proposition that sustainable use and protection of tropical forests merits more attention from development agencies than it may have received in the past. He commended the Bank's support for the Institute's work, and noted that the FAO Action Plan on Tropical Forests had endorsed the effort. Further, Secretary Baker proposed an intensive series of discussions between U.S. agencies and the regional Bank Vice Presidents to examine the possibilities for investment in the countries to which the Bank lends.

On March 17, President Clausen responded by welcoming the Secretary's interest and agreeing to appropriate meetings. The meetings are to be scheduled over the next few months and will provide an opportunity to identify which of the ideas advanced by the Institute will be funded by the Bank.

We are currently considering two additional areas where environmentally beneficial projects might be identified: (a) elements to strengthen irrigation projects and render them more environmentally beneficial and (b) opportunities for encouraging energy conservation through project activity. As we proceed, we will be identifying additional areas that offer good prospects for environmental benefit.

## The Inter-American Development Bank

In recent months, U.S. agencies, in cooperation with the office of the Executive Director, have been closely monitoring the Bank's organizational effectiveness in managing the environmental dimensions of projects.

Unlike the other three development banks, the Inter-American Development Bank does not have a distinct administrative unit specializing in environmental matters. The diffusion of responsibility throughout the Bank staff is consistent with the way the Bank manages other important operational planning and decision-making, for example, adherence to procurement policies. It is also consistent with an overall emphasis on flexible staff deployment to address operational issues.

The typical Bank approach is to form a task force of knowledgeable staff to address a specific operational issue and to hold the task force members jointly accountable for their product, as it is reviewed, jointly, by their administrative supervisors. Thus, a proposed project loan will be reviewed and documents will be prepared by a project committee composed of staff from various Bank units. The staff's report will be reviewed by a mid-management committee and, at a later stage, by a senior management committee.

If a sound approach to the management of environmental aspects of projects does not already exist in an institution with this type of organizational structure, it can only be achieved by the development of a positive consensus at virtually the same time throughout the Bank. It is easier to attain such a consensus at senior levels and to have it permeate downward, because fewer individuals are involved. We believe such a consensus is now forming in the Bank.

Our review of the organization to manage environmental aspects of Bank activities was initiated in August 1985 when the Executive Vice President of the Bank agreed to provide U.S. agencies and the U.S. Director regular briefings on the activities of the Bank's Committee on

Environmental Management. The Committee was created in November 1983 and is composed of senior Managers from several Bank departments. The members are Jorge D. Ferraris (Manager of the Project Analysis Department and Chairman of the Committee), Rubens Vaz da Costa (Manager of the Operations Department), Richard Fletcher (Acting Manager of the Plans and Programs Department), Miguel Urrutia (Manager of the Economic and Social Development Department), Jerome I. Levinson (General Counsel), and Marian A. Czarnecki (External Relations Advisor).

From late 1983 until early 1985, the Committee did little, with only one project placed under intense review. In these circumstances, it is difficult to reach a consensus among senior Managers on how to approach the environmental aspects of projects. As a result, the staff of the Bank receives inconsistent guidance from respective supervisors in the conduct of its work.

The nature of the supervision of staff may, in part, explain why we have found a very mixed picture. Some projects reflect sound environmental planning; some do not. Yet, we usually find that the staff understands the environmental problems well.

In the latter months of 1985 and in early 1986, we found a change in the pattern of activities of the Committee. First, at a purely administrative level, the meetings were more frequent, lasted longer and covered a larger number of projects. Second, discussions with Bank staff on individual projects revealed that environmental aspects were planned and thought through far more frequently, although not always. Third, available information on the actual proceedings and conduct of the Committee meetings indicates that the discussions have been professional and serious. Finally, in October, administrative steps were initiated to identify systematically environmentally sensitive projects at an early stage in the project development process.

In the final analysis, the most significant motivational element appears to be a growing awareness among senior managers that inconsistent attention to environmental aspects of projects, in addition to yielding political embarrassment, is associated with disappointing project implementation and a less-than-satisfactory contribution to the development of borrowing countries.

In addition to overseeing the operations of the Bank's Committee, our Director has taken other steps to promote a more effective management of the environmental aspects of projects. First, with the recent addition of an Alternate Executive Director, our Director assigned him the responsibility for systematically supervising these matters. Second, the U.S. Director has repeatedly cited environmental concerns in specific projects.

The U.S. Governor to the March IDB Annual Meeting formally requested all members to pay greater heed to environmental matters. With this impetus, our Director will be proposing several additional steps in the coming weeks:

-- A request to continue briefings on the activities of the Committee on Environmental Management throughout 1986.

-- The creation of one or two Environmental Analyst positions in the Bank. As part of staff level project committees, the Analyst(s) would be responsible for reviewing projects in the especially sensitive agriculture, rural roads, and power sectors to identify areas where multidisciplinary analysis and design work is needed to plan a project properly.

-- The review of requirements for anthropologists on the Bank staff. The single anthropologist currently employed has other responsibilities beyond her technical training, while the number of Bank projects which affect cultural minorities in borrowing countries is substantial.

-- A review in a seminar for Board members of a recently prepared evaluation of hydroelectric projects.

-- The preparation of evaluations of environmental aspects of past Bank projects for agriculture and road construction, with subsequent discussion in a seminar for Board members.

-- An explicit statement in all Bank project reports as to whether Ministers for Environment and Health or equivalent agencies have been consulted in the preparation of the project.

-- An explicit statement in all Bank project reports as to whether nongovernment conservation and indigenous peoples organizations have been consulted in project preparation.

Following our discussions with the World Bank on investment to manage and protect tropical forests (which I have discussed above), we will instruct our Director to enter into discussions on investment in the forestry sector by the Inter-American Development Bank. In 1983, the Bank had no loans for the forestry sector; in 1984, there was one loan to Venezuela for $34.3 million; but, again, in 1985, there were no loans for the sector. While there were components of other loans which addressed forestry needs, and borrowing country financial circumstances have been understandably constrained, we believe the Bank could be doing more, and our Director will solicit Bank views on specific project possibilities in the coming months.

In the case of the Inter-American Development Bank, our Director's discussions on the provisions of the Act are less advanced than in the other Banks. Under our instructions, he has been placing a priority on strengthening organizational effectiveness which offers positive prospects for strong Bank performance in the environmental area.

## The Asian Development Bank

On January 23, the U.S. Director took advantage of a previously scheduled Board meeting to review the Bank's Environmental Policies and Procedures in order to initiate the implementation of his instructions flowing from the provisions of the Act.

In preparation for the Board meeting, the Bank issued a paper which was the product of an internal review which included Bank staffing requirements. On the basis of this internal review, Bank Management concluded that two environmental specialists were adequate to meet the needs of the Bank at the present time, provided that the emphasis in their activities shifted from spending some time reviewing all projects, to providing a significant input on those projects expected to have important adverse impacts. In the case of other projects, most of the responsibility for dealing with environmental matters would be delegated to project staff. The environmental specialists were to continue their support for projects with important environmental benefits, such as the series of environmental planning projects that have been carried out in recent years in several borrowing countries.

The Board, including the U.S. Director, agreed that with the re-direction of the efforts of the environmental specialists, two staff members were adequate for the time being. Our Director proposed in a paper circulated to Board members that all project appraisal reports include a specific notation in the environmental section, describing the role that environment and health ministries played in project preparation. He also suggested that the project appraisal report include a discussion of the extent to which nongovernmental conservation organizations and organizations working with local communities and cultural minorities were consulted during project preparation.

During the Board discussion, our Director agreed with the remark from the Director representing a group of Developing Member Countries that the construction of a dam, or even of new roads, could have negative as well as positive effects on the residents of the affected areas. Our Director added that areas meriting special attention included river basin development, resettlement projects, road building and road improvement, citing the previous discussions in the Board on the difficulties caused in Nepal by penetration roads. He suggested that the Project Evaluation Office examine the environmental consequences of projects more systematically.

Our Director added that correct identification of property rights had been an important issue in the United States, as it was the key to controlling harmful environmental effects through market mechanisms. It was necessary to be able to identify those who had water rights, and those with land rights. He suggested that the Bank include examination of property rights in its program.

The discussion at the Board meeting among the Directors suggested that most Developing Member Country Directors see environmental consideration in competition for financial resources with other development activities. The conclusion of those holding this view was that more financial resources would be needed to improve environmental conditions in borrowing countries. However, there was some recognition that development activities could be planned to coincide with sound environmental management, and there appeared to be significant support for the preparation of national environmental sector profiles.

Most of the Directors from developed countries struck a less ambivalent note and with varying degrees of vigor urged the Bank to continue or expand its activities in support of sound environmental policies. Of specific interest in the context of the suggestions in the *Act* was the suggestion by one Director that executing agencies coordinate their work with local organizations and keep local populations involved and integrated as much as possible with projects.

The Board endorsed a staff proposal to continue or, if possible, expand funding for regional development or environmental master plans. With the staff's experience in preparing and implementing these types of operations, this appears to be an especially fruitful area for expanding the Bank's inventory of environmentally beneficial projects. After discussing the possibilities for investment in the protection and management of tropical forests in Asia with the World Bank, we plan to instruct our Executive Director to explore the possiblities for Asian Development Bank support for such projects.

## The African Development Bank

In a February trip to Washington for consultations, the U.S. Executive Director was briefed on the requirements of the *Act*. He suggested that, in view of the size of the Board and the proponderance of borrowing country Directors, it would be best to begin our efforts to achieve the goals of the *Act* by consulting informally with other Directors.

In April, he was issued instructions to discuss five subjects informally with other Directors:

- First, the capacities of universities or other research or educational institutions and other professional entities in borrowing countries might be more effectively utilized, if the Bank staff were to make a systematic assessment of nongovernmental organizations or institutions that have a capacity to help design, implement, monitor or evaluate conservation aspects of projects.

- Second, such conservation organizations, where capable, might provide a source of information even without a formal role in the project process. To tap this potential, the Bank staff could be asked to consult with these organizations and to indicate in each project appraisal report for agriculture, dams and road construction whether such outside organizations have been consulted.

- Third, most borrowing governments have agencies with environmental or health responsibilities. The effects of project activity on the environment or human health, which should be considered during the design stage, could appear to be an appropriate subject for consultations with such agencies. The appraisal reports for projects in critical sectors could include notations regarding whether such agencies had been consulted.

- Fourth, since the contract for the Bank's environmental specialist will conclude in December 1986, it appears to be an appropriate time to examine staffing and organization.

- Fifth, the desirability of additional training for Bank staff might be considered.

After our Director reports on his discussion of these subjects with his colleagues, our next step will be to insert specific ideas in the U.S. Governor's speech at the Annual Meeting in early May. There will, then, be additional instructions sent to initiate discussions on these subjects with Management and, more formally, within the Board of Directors. We expect that the instructions will also include ideas for investment in tropical forest protection and management.

## The Economic Development Institute

The provision of the Act related to the Economic Development Institute suggested adding a component to the curriculum which would provide training in environmental and natural resource planning and program development.

Currently, EDI offers about ninety courses annually in many economic sectors. The courses are designed to encourage mid-management and policy officials to stress market-oriented economic policies heavily in their development planning.

We thought carefully about how EDI might best be mobilized to help strengthen the environmental aspects of such planning. It seemed to us that it might be best to incorporate environmental components in the existing course structure. This approach offers the best opportunity to integrate development objectives with environmental considerations.

With the support of the Acting U.S. Director, staff members of the Departments of State and Treasury held several meetings with the EDI staff on January 21 and February 5 to examine how such an integration might be accomplished.

There appears to be considerable sympathy in the EDI for the importance of covering natural resource management issues as part of its program. And there are some tentative moves in that direction. Specific examples include an experimental offering on water resource management to be held this year in Korea, and a course to be held this fall on land and water management policy in agriculture. One EDI official referred to what he felt was a "demand side" for course components and materials on environmental and resource management issues, a demand both from some EDI course participants and from some of the institutions with which the Institute cooperates in presenting its courses.

However, there appears to be no established guideline nor directive to EDI to devote more attention to environmental and natural resource management issues. As a result, it is perhaps not surprising that there appears to be no integrated effort within the Institute to incorporate consideration of specific environmental issues into existing courses (for example, irrigation management), or broad natural resource management questions and priorities in, for example, general economic policy courses.

Complicating the situation is the nature of the relationship between EDI and cooperating educational institutions in other countries. Almost all courses are offered abroad at the facilities and in cooperation with other institutions. This means course content must be based on agreement between the Institute and a second institution. An advantage of the arrangement is that EDI can offer many courses with relatively few staff members; but a disadvantage is that EDI staff is stretched thin and has little scope to entertain complex initiatives on its own.

Another constraint is the general approach to the African continent, including a marked emphasis on macroeconomic issues in near-term structural adjustment, as distinct from more broadly focussed, longer-term approaches to economic priority setting and management. The EDI staff recognizes the need to manage natural resources in a way that promotes long-term development.

Finally, almost without exception, the staff members who were interviewed agreed that a key to the effectiveness of EDI courses is the caliber and, even more important, the mix of the participants in the courses and seminars. In relation to resource management issues, there is an effort in parts of the Institute to obtain a good variety of professional experience among participants in the seminars. For example, an articulate Agriculture Minister addressed resource management issues effectively in a recent economic policy seminar.

Based on these findings, we confirmed our initial view that a separate course would not be the most effective approach. An integration of environmental and natural resource management issues into existing course coverage appears the better alternative.

In order to implement this conclusion, we will instruct the Acting U.S. Director to obtain Management support and, if necessary, support from other Directors for:

-- An explicit Management directive to establish environmental and natural resource management as a goal of the EDI program on a par with other goals, and

-- An EDI-funded consultant on environment and development who would:

  * Review each of the ninety courses and offer appropriate recommendations on course content,

  * Identify courses where the participation of officials responsible for natural resources, environment or health might be desirable,

  * Identify the written materials that should be introduced in specific courses,

  * Identify developing country officials who are especially effective in integrating these subjects and who may appropriately participate in EDI courses,

  * Identify group discussion leaders capable of integrating natural resource or environmental issues with other subjects relevant to the EDI curriculum,

  * Identify any possible additional courses that might be offered,

  * Offer any pertinent observations on EDI staffing or budgeting matters.

These steps will require some months to complete, but we believe they offer the most sound and cost-effective means of enhancing the contribution that EDI can make to an effective integration of environmental considerations into development planning and execution.

## How We Plan to Proceed in the Banks

As is evident by the foregoing, the process of achieving the reform objectives of the Act has begun but has not been completed. We plan to follow through.

In this connection, it is encouraging to find that a number of other member countries are showing a growing interest in the environmental aspect of bank activities. During international meetings held on January 26, February 12 and, more recently, April 7 and 8, representatives of other member governments have welcomed the initiatives from the United States that were required under Section 540 (c) of the Act. The willingness of other governments to take an active interest in these matters has been reflected in increasingly frequent Board discussion of environmental aspects of specific projects, especially in the World Bank.

Several months more will be required before we see reforms in place and, given the lag in project preparation, it may be a year or more before we see a marked change in projects coming to the Board for approval. Even then, the outcome may not be entirely satisfactory.

We have been reviewing the environmental aspects of bank projects over the last three years systematically. Overall, we have found that problems in projects seem to arise for one or more of the following reasons: (a) low priority for the environmental aspects of projects in the banks or in borrowing governments, (b) an unwillingness in borrowing governments to take on the financial burdens associated with effectively addressing environmental aspects of projects, and (c) decisions in the allocation of natural resources in borrowing countries among competing groups which reflect the outcome of internal political and economic debates over resource use.

The suggested reforms in the Act can effectively address the first two reasons. With improved use of human resources and available sources of information, the banks should be able to give an appropriate priority to environmental considerations and should be in a position to explain clearly to borrowers why the additional investment in environmental protection initially will be repaid in terms of more sustainable development. In instances where the unsustainable use of natural resources is the result of clear decisions flowing from internal political and economic debates within borrowing countries, the banks will have to decide whether to seek improvements in project activity that is inherently unsustainable, or desist entirely from lending in such areas.

This report must necessarily have an interim quality. The tempo of our efforts in the banks suggests that there should be significant developments in the next two to three months. Accordingly, we will report to you further by June 30.

In the meantime, if you wish further detailed information on our implementation of the provisions of Section 540 of the Act, I would be happy to arrange briefings by appropriate Treasury officials.

Sincerely,

J. Michael Hudson
Assistant Secretary-Designate
(Legislative Affairs)

The Honorable
Jamie L. Whitten
Chairman
Committee on Appropriations
U.S. House of Representatives
Washington, D.C. 20515

THURSDAY, MARCH 13, 1986.

## EXPORT-IMPORT BANK

### WITNESSES

**HARRY S. HAVENS, ASSISTANT COMPTROLLER GENERAL**

**ALLAN MENDELOWITZ, ASSOCIATE DIRECTOR, NATIONAL SECURITY AND INTERNATIONAL AFFAIRS DIVISION**

**DENNIS DUQUETTE, ASSOCIATE DIRECTOR, ACCOUNTING AND FINANCIAL MANAGEMENT DIVISION**

**JOHN A. BOHN, JR., FIRST VICE PRESIDENT AND VICE CHAIRMAN, EXPORT-IMPORT BANK OF THE UNITED STATES**

Mr. MRAZEK [presiding]. The hearing will come to order.

Again I want to welcome our witnesses and also express the apologies of the Chairman of the Subcommittee for not being able to be in attendance. However, he is participating in a floor debate on the President's budget right now and has asked me to fill in as Chairman.

I would like to accept the statement of Mr. Havens for the record.

[The statement of Mr. Havens follows:]

UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

FOR RELEASE ON DELIVERY
EXPECTED AT 2:00 P.M.
MARCH 13, 1986

# STATEMENT OF
# HARRY S. HAVENS, ASSISTANT COMPTROLLER GENERAL
# BEFORE THE
# SUBCOMMITTEE ON FOREIGN OPERATIONS
# OF THE
# HOUSE COMMITTEE ON APPROPRIATIONS
# ON THE
# FINANCIAL CONDITION OF THE EXPORT-IMPORT BANK OF THE UNITED STATES, ITS PROPOSED INTEREST MATCHING PROGRAM, AND ALTERNATIVE FUNDING PROPOSALS

Mr. Chairman and Members of the Subcommittee:

I want to thank you for the opportunity to offer testimony today concerning the financial condition and reporting practices of the Export-Import Bank of the United States (the Bank). I also will address the Bank's proposed interest matching program, which is intended to replace its direct lending program, and the suggested alternative for appropriating funds to the Bank.

To summarize our views on these matters,

--We are concerned that the Bank's financial statements do not fairly present the full cost of the Bank's operations because the Bank does not recognize the significant losses inherent in its problem loans.

- --We believe that the proposed interest matching program would be more costly to the government than direct loans. We also believe it would be unfortunate if the proposed shift to loan guarantees--without changing the substance of the transactions--had the effect of taking the Bank's lending activity out of the budget.

- --As a temporary measure, we believe there is merit in the proposal for a direct appropriation which would also serve as the Bank's annual limitation on direct lending. However, we believe any infusion of capital should be accompanied by a requirement that the Bank recognize loan losses in its financial statements through the establishment of an appropriate loan loss reserve.

## THE BANK'S FINANCIAL POSITION

GAO annually audits the Bank's financial statements, and we are currently engaged in an audit of the Bank's fiscal year 1985 financial statements. I will discuss the results of our prior audits and our preliminary analysis of the Bank's 1985 financial data.

The Bank reported net losses in its fiscal years' 1982, 1983, and 1984 financial statements of $160, $247, and $343 million, respectively. In fiscal year 1985, the Bank will record a larger net operating loss, estimated to be about $378 million.

The yearly operating losses reported by the Bank result primarily from three sources: (1) the amount by which interest expense exceeds interest revenue, (2) the amount by which the cost of insurance and guarantee claims exceeds insurance premiums and guarantee fees, and (3) administrative expenses. These operating losses have reduced the Bank's retained earnings from $2.0 billion at September 30, 1982, to $1.4 billion at

September 30, 1984. By far, the largest source of losses reported by the Bank has been the negative interest rate differential. It is expected that the fiscal year 1985 loss will further reduce the Bank's reported retained earnings to about $1.1 billion.

This trend of increasingly larger reported losses is only part of the story. The Bank's accounting practices, which do not recognize loan losses, have resulted in retained earnings which are reported at artificially high amounts. In our view, the value of the Bank's loan portfolio is substantially overstated for the following reasons.

First, delinquent loans at September 30, 1982, were reported at $1.4 billion, or 8.3 percent of total loans receivable. Preliminary data as of September 30, 1985, show delinquent loans will be $2.8 billion, or 16.3 percent of total loans receivable.

Second, the total amount of loans receivable which had delinquent installments prior to a rescheduling has increased from $1.2 billion at September 30, 1982, to $3.4 billion at September 30, 1985. This represents an increase from 7 to 20 percent of total loans receivable. Reschedulings also distort the financial picture in another way since previously recorded but unpaid interest is consolidated into the current debt. Under current Bank accounting practices, this amount is assumed to be fully collectible. The Bank then also records interest on the total amount rescheduled. At September 30, 1984, total interest added to loan principal balances and included in the Bank's retained earnings was $267.6 million, up from $125.8 million at September 30, 1982.

The Bank also has recorded as income interest that has become delinquent. The Bank assumes the delinquent interest will be collected and does not provide for any allowance for loss. That delinquent interest at September 30, 1984, was $278.1 million, up from $149.0 as of September 30, 1982.

Finally, the Bank operates guarantee and insurance programs. Under these programs, when a borrower defaults on an insured loan and the Bank is obligated to pay a claim, the Bank often treats the claim payment as a loan receivable. The net loans purchased, which are included in loans receivable, more than tripled from $288.5 million in 1982, to $984.2 million in 1985.

We consider loans that are currently delinquent, under reschedulings, or recorded as loan purchases to be "problem" debt because they exhibit characteristics suggesting that a significant portion will ultimately prove to be uncollectible. The total problem debt, as of September 30, 1982, was $2.1 billion, or 12.7 percent of total loans; by 1984, that problem debt had more than doubled to $4.7 billion, or 26.3 percent of total loans. These amounts will again increase for fiscal year 1985.

Our attached analysis of the Bank's financial condition indicates that the amount of problem loans is increasing while the Bank's retained earnings are dwindling. At September 30, 1982, problem loans were roughly equal to the Bank's retained earnings. However, by September 30, 1984, problem loans, as a percent of the Bank's retained earnings, had risen to 322 percent. Preliminary estimates indicate problem loans will exceed 400 percent of the Bank's retained earnings as of September 30, 1985.

It is important for me to point out that we are not criticizing the Bank's rescheduling practices; these are policy decisions between the Congress and the Bank. We are concerned, however, that the results of these policies are not appropriately accounted for and fully disclosed in the Bank's financial statements.

Fair presentation of loans receivable requires a recognition in the accounts of the diminished value of loans through a charge against current year's income and a corresponding increase in an allowance for loan losses. The Bank has not recognized that its loans are impaired--even when the foreign governments repudiate the debts. The result, in our opinion, is a loan balance which is not fully collectible and, accordingly, is overstated.

The Bank reported retained earnings of $1.4 billion as of September 30, 1984. If an allowance for estimated loan losses had been provided, we estimate the Bank's retained earnings would decrease by $1.0 to $1.5 billion. This would result in a retained earnings of between $400 million and a deficit of $100 million, as of September 30, 1984. Admittedly, our approach involves judgment, but determining an allowance for losses, a common practice of financial institutions, is rarely subject to precise measurement.

One significant result of not recognizing loan losses is the potential impact on congressional oversight. As shown on the statements, the Bank's financial position does not appear as severe as it is in reality, and the Congress may be led to make policy decisions that it would not otherwise make were the Bank's true financial condition fairly presented.

## THE BANK'S PROPOSAL FOR AN INTEREST MATCHING PROGRAM

The Bank proposes to restructure its subsidized loan program to finance the loans with agency guaranteed borrowing rather than by Treasury borrowing. In its fiscal year 1987 budget request the Bank is requesting authority to provide interest subsidies on $1.8 billion of guaranteed export loans to counter foreign government-supported export credit subsidies. Lenders would be selected competitively but would be guaranteed payment of interest and principal. Since the interest rate arranged for an export loan may be below the market rate at which the commercial lender would normally make such a commitment, the Bank will pay the commercial lender the differences between the rate committed on the loan and the market rate. The Bank estimates that the present value of the subsidy associated with the $1.8 billion over the life of the credit would be about $100 million.

One possible effect of this proposal is to take Bank transactions off budget for the purpose of calculating the federal budget deficit. The impact on the economy of a government loan guarantee is similar to that of a direct government loan. The Congressional Budget Office (CBO) has noted that the substance of the transaction will not change, only its form. CBO has thus decided that the budgetary scorekeeping of the transactions should not change. We agree that it would be unfortunate for form to triumph over substance, particularly in the Gramm-Rudman-Hollings era, when the way we decide to count things can cause real differences in the results.

Also, the proposal would incur increased cost to the government; that is, it would be more expensive for the government to provide a loan guarantee coupled with a subsidy to reduce interest rates than to provide a comparable direct loan with an equivalent interest rate. The reason is that the cost to commercial lenders of borrowing with a government guarantee is higher than the cost to the U.S. Treasury of borrowing on comparable terms. The cost differential would probably range between 25 to 75 basis points. Therefore, any subsidized loan guarantee would have to include the cost of this differential in its direct cost. Hence, the added cost in the first year on the first $1 billion in subsidized loan guarantees used in place of direct loans could be $2.5 million to $7.5 million. If such a program were continued at a constant level for several years, the annual cost would get substantially larger--by the fifth year, the additional annual costs could be $12.5 million to $37.5 million if the loans all have a term of at least 5 years. On a present value basis, these costs would range from $10.8 million to $32.3 million.

## ALTERNATIVE APPROPRIATIONS PROCEDURES

You also asked that we address alternative methods for appropriating funds to the Bank. We understand that a suggestion has been made to provide a direct appropriation to the Bank which would also serve as the Bank's annual limitation on direct lending.

As we have already observed, if the Bank's financial statements properly reflected the quality of its loan portfolio by establishing an appropriate loan loss reserve, the Bank's total capital and retained earnings would be substantially less than is currently reported.

Under these circumstances, an appropriation to restore the Bank's capital may well be appropriate. However, the amount of the capital infusion needed is not necessarily the same as the level of direct lending which may be appropriate for any given fiscal year. If an appropriation of that size were provided every year, it would soon produce a level of capitalization well in excess of the Bank's needs.

Accordingly, if Congress choses to link the two items in a single number this year, we suggest that you make it clear that this is a temporary measure and that it should not be viewed as a long-term precedent. In addition, we urge that any infusion of capital be accompanied by clear direction to the Bank that its financial statements should reflect an appropriate loan loss reserve. Once the Bank's capitalization has been properly stated on its financial statements and restored to an appropriate level, we suggest that the Congress consider an annual appropriation to restore any further depletion that will have been reflected in the audited statements.

## GAO ANALYSIS OF THE FINANCIAL CONDITION OF THE EXPORT-IMPORT BANK OF THE UNITED STATES

(ALL AMOUNTS IN MILLIONS)

| | | (4) (UNAUDITED) FY 85 | FY 84 | FY 83 | FY 82 |
|---|---|---|---|---|---|
| LOANS RECEIVABLE | | $16,860 | $17,504 | $16,883 | $16,565 |
| PROBLEM LOANS | (1) | | | | |
| DELINQUENT LOANS | | $2,753 | $2,707 | $1,904 | $1,377 |
| % OF TOTAL LOANS | | 16.3% | 15.5% | 11.3% | 8.3% |
| RESCHEDULINGS | | $3,370 | $1,546 | $1,194 | $1,178 |
| % OF TOTAL LOANS | | 20.0% | 8.8% | 7.1% | 7.1% |
| LOANS PURCHASED | | $984 | $757 | $397 | $289 |
| % OF TOTAL LOANS | | 5.8% | 4.3% | 2.3% | 1.7% |
| TOTAL PROBLEM LOANS | (2) | (5) | $4,663 | $2,654 | $2,098 |
| GROWTH (FY82 BASE) | | (5) | 222% | 126% | 100% |
| REVENUES: | | | | | |
| INTEREST REVENUE | | $1,478 | $1,458 | $1,342 | $1,272 |
| FEES, PREMIUMS & MISC | | $85 | $99 | $82 | $124 |
| EXPENSES: | | | | | |
| INTEREST EXPENSE | | $1,828 | $1,746 | $1,624 | $1,479 |
| NET LOAN WRITE-OFFS | (3) | $5 | ($20) | $5 | $32 |
| NET CLAIMS PAID | (3) | $78 | $139 | $14 | $25 |
| ADMIN AND OTHER | | $30 | $35 | $27 | $20 |
| NET LOSS | | ($378) | ($343) | ($247) | ($160) |
| CAPITAL | | $1,000 | $1,000 | $1,000 | $1,000 |
| RETAINED EARNINGS | | $1,072 | $1,450 | $1,792 | $2,040 |
| CAPITAL AND RETAINED EARNINGS | | $2,072 | $2,450 | $2,792 | $3,040 |
| UNREALIZED INTEREST INCOME | | | | | |
| RESCHEDULED | | $394 | $268 | $199 | $126 |
| DELINQUENT | | $315 | $278 | $186 | $149 |
| CAPITAL AND REALIZED EARNINGS | | $1,363 | $1,904 | $2,407 | $2,765 |
| TOTAL PROBLEM LOANS | | (5) | $4,663 | $2,654 | $2,098 |
| AS A % OF RETAINED EARNINGS | | (5) | 322% | 148% | 103% |
| AS A % OF CAP & RETAINED EARN | | (5) | 190% | 95% | 69% |
| AS A % OF CAP & REALIZED EARN | | (5) | 245% | 110% | 76% |

NOTES:

1- LOANS THAT EXHIBIT CHARACTERISTICS THAT LEAD TO DELINQUENCY AND ULTIMATE UNCOLLECTIBILITY
2- EXCLUDING DOUBLE-COUNTING AMONG CATEGORIES
3- INCLUDES "LAKER AIRWAYS" LOSS OF $50M IN FY82 AND $35M GAIN IN FY84
4- PRELIMINARY FY85 DATA; UNAUDITED
5- AMOUNT AND PERCENTS CURRENTLY UNAVAILABLE; WILL INCREASE OVER FY84

Mr. MRAZEK. Do your want to reiterate any of the key points again?

Mr. HAVENS. I think in the interest of time, sir, that we might dispense with that. I might for the record introduce my colleagues at the table. With me today on my left is Mr. Allan Mendelowitz, Associate Director of our National Security and International Affairs Division, responsible for the trade, energy and finance areas of our work; on my right is Mr. Dennis Duquette, Associate Director, Accounting and Financial Management Division, the division responsible for financial statement audits, including the audit of the Export-Import Bank. With that, I would propose that I submit my statement for the record as you have suggested, and that we proceed immediately to any questions you may have.

Mr. MRAZEK. Thank you very much.

I would also like to express my apology to you and to your staff as well as to Mr. Bohn and other witnesses due to the late starting of this hearing.

### GAO'S 1985 AUDIT

I understand the GAO is working on a new audit of the 1985 books for the Export-Import Bank. Could you tell us when it will be available for the committee to review?

Mr. HAVENS. I believe we are in the drafting stages on that.

Mr. DUQUETTE. Perhaps the end of April or early May is what we are looking at.

### LOAN LOSS RESERVES

Mr. MRAZEK. If reasonable loan loss reserves were accounted for in 1985, would you estimate that the bank by now would have completely depleted its retained earnings?

Mr. HAVENS. I think it is quite likely that that would be the conclusion. Our work is still preliminary in that regard. The bank has not in the past recorded a reserve for losses. We would much prefer that the bank itself estimate what that reserve for losses should be. Given that the bank so far has not done so, in our audit of the 1984 statements we estimated that the appropriate reserve for losses would be in the billion to billion-and-a-half range. This would have reduced their retained earnings at that point, if properly stated, to somewhere between $400 million and minus $100 million.

Our observation at this point is that the condition has continued to worsen with respect to the probable losses. So, taking that as a given, I would suspect retained earnings would be in the negative numbers at this point.

### LOANS TO CUBA

Mr. MRAZEK. Why would you question the sincerity of the Export-Import Bank when they suggested they fully expect that loans made by the Export-Import Bank in 1951 to Mr. Batista in Cuba aren't going to be paid back?

Mr. HAVENS. In our judgment it is highly remote that Cuba, having repudiated the debt 20 years or more ago, would suddenly decide that they wanted to restore their relationship to the point of stating a willingness to repay.

### LOANS TO CHINA

Mr. **Mrazek**. You don't think the People's Republic of China wants to make good on the loan we made in 1946 through the Export-Import Bank to Chiang Kai-shek?

Mr. **Havens**. I would say it seems unlikely.

Mr. **Mrazek**. I would agree with you. I would share your skepticism in that regard.

### LONG-TERM IMPACT OF NEGATIVE RETAINED EARNINGS

I am curious as to what the long-term impact of a negative retained earnings portfolio would be if in fact the books were cleaned up, so to speak.

Mr. **Havens**. Well, as I said, at this point my guess would be that retained earnings would be negative if the books were stated as we would suggest that they should be. The long-term implications are a little more difficult to state. The bank is an agency of the government. I suppose in principle there is nothing that would preclude the bank from continuing to operate if its retained earnings were in a deficit position, even to the point of consuming its entire capital base.

It seems to me the issue here is the proper presentation of the cost of the operations which the bank undertakes. The extent to which we do not recognize probable losses due to the uncollectibility of loans understates the true cost of the bank's operations and the programs that the bank is carrying out.

To the General Accounting Office the appropriate disclosure of the cost of operations is a very important issue, and we are not saying that, properly disclosed, those costs would raise doubts about the wisdom of continuing the bank or anything like that. But we are saying that the Congress should know what those costs are when they authorize a program.

### FINANCIAL REPORTING STANDARDS

Mr. **Mrazek**. The financial reporting standards that you are suggesting should be adhered to by the Export-Import Bank, are these standards any different than standards that would apply to private banks?

Mr. **Havens**. Not in our judgment, no. They should follow generally accepted accounting principles which are applicable to commercial operations. For financial reporting there should be no difference.

### EXPORT-IMPORT BANK'S ADHERENCE TO FINANCIAL REPORTING STANDARDS

Mr. **Mrazek**. Since these criticisms have been made for several years now, as to the financial reporting of the Export-Import Bank, why do you think the Export-Import Bank has refused to adhere to these kinds of standards?

Mr. **Havens**. I would prefer not to speculate as to why the bank has chosen the position that it has chosen. It seems to me the bank is quite capable of explaining for itself why it has chosen not to adhere to the standards. Recently we audited the bank's financial statements and judged that those statements do not properly reflect the financial condition of the bank.

### COLLECTIBILITY OF PROBLEM LOANS

Mr. **Mrazek**. When you make a recommendation as far as a loan loss reserve, how would that impact on the collectibility of these problem loans?

Mr. **Havens**. The establishment of the reserve itself should have no effect on their actual collectibility. It is simply an attempt to express in financial terms a reasonable estimate of the likelihood of collectibility. We have no problem with the bank seeking to collect loans that are probable losses. Also, rescheduling loans is nothing that we have raised objection to. Establishing a loan loss reserve should not affect the behavior of the bank or the relationship with its borrowers.

### QUALITY OF EXPORT-IMPORT BANK LOANS

Mr. **Mrazek**. Did you attempt to make a judgment as to the wisdom of the types of loans that were being made during that given year when you were reviewing whether they represented a good risk for the Export-Import Bank?

Mr. **Havens**. My answer would be that that is a matter between the bank and the Congress as to the policies which the bank should pursue and the sorts of risks which it should take on. We have not made any judgment as to whether those risks were wise or unwise. We are simply trying to attest to the fair presentation of the financial statements.

### DISCLOSURE OF PROBLEM LOANS

Mr. **Mrazek**. Should there be a mechanism by which Congress is apprised of problem loans, or the government, so that there would be some public revelation of problem loans during a given reporting period by the bank? Would that be a help?

Mr. **Havens**. I don't think it is a matter of identifying individual borrowers who fall into a problem category. I can recognize a number of good and sufficient reasons for not disclosing that sort of information. That could very well affect the relationship between the bank and its borrowers. In fact disclosure of this information could precipitate a collectibility problem. So we are not suggesting that individual loans be identified and written off. Rather, we are suggesting that loan loss reserves be established against the portfolio as a whole, without identifying to any particular borrower.

### MECHANICS OF LOAN LOSS RESERVE

Mr. **Mrazek**. Can you briefly explain how a loan loss reserve would actually work and how it would impact on these types of loans?

Mr. **Havens**. Well, the normal practice followed in the commercial sector is to classify loans in terms of various degrees of risk based upon the condition of the borrower, the borrower's financial outlook, the economic outlook, and then, based on any of a variety of criteria which are available and are used in various institutions, judge the probability of collection. Above a certain classification, there is usually no requirement for a loan loss reserve to be established, or at most a fairly minimal one.

With respect to countries or other borrowers who are finding it difficult to repay, or are delinquent in repaying, either principal or interest or both, it is normal in commercial practice to establish a reserve for losses, recognizing that the quality of the portfolio has deteriorated from its original condition. That is generally the process, and there are a variety of criteria that could be used.

Mr. **Mrazek.** This is a reserve that would protect the positive retained earnings nature of the——

### PURPOSE OF LOAN LOSS RESERVE

Mr. **Havens.** No, it is not. It is not a bundle of cash sitting there. It is an attempt to recognize in the bank's statement of financial condition the losses that it has faced or that it will face in the future through collectibility problems. It is an attempt to state the value of the portfolio in net realizable value terms, recognizing the risks that are inherent in the portfolio.

### NEED FOR APPROPRIATIONS AS A RESERVE

Mr. **Mrazek.** So the Congress couldn't have appropriated any money to create a reserve?

Mr. **Havens.** No. However, in the long run, if the Congress wished, the capitalization of the bank could be maintained at a particular level—$2 billion is a number that has been discussed as an appropriate level, and I don't know whether that is right or not, I will leave that to the judgment of the Congress. Each time the loan loss reserve is increased, that constitutes a charge against current operations and, ultimately, retained earnings. So if the Congress wished to maintain the capitalization at say the $2 billion level, an appropriation would be warranted to restore capital, and retained earnings to that level.

### IMPACT ON FUTURE LENDING

Mr. **Mrazek.** So in essence, by facing up to what is a lot of bad debt expense in the portfolio, the Export-Import Bank would be reduced in its capability to lend out money for the future?

Mr. **Havens.** I am not sure that I would state it quite that strongly. The bank has borrowing authority which to the best of my knowledge is not restricted by the need to maintain a particular level of capital. And since the bank is borrowing from the Treasury in the form of the Federal Financial Bank, there is no necessary restraint in fact on the bank's borrowing, even though its capital position may be negative. That could go on as long as Treasury and FFB were prepared to lend it money, which I suspect it would do as long as Congress told them to. So it would not necessarily cause the bank to cease operating or to be unable to borrow from its normal sources even though its capital were entirely depleted.

### I-MATCH PROGRAM

Mr. **Mrazek**. You commented in your report on the I-match approach that the administration seeks to utilize. Am I correctly characterizing your report to suggest that this would just give the appearance of reducing the federal budget deficit but would really be more expensive to the Federal Government in the long run?

Mr. **Havens**. That is a fair characterization, yes, sir.

### CONGRESSIONAL OPTIONS TO REQUIRE APPROPRIATE ACCOUNTING

Mr. **Mrazek**. The Congress would have what options at this point to basically require the Export-Import Bank to reflect the kind of bookkeeping practices that you think are warranted for the Export-Import Bank?

Mr. **Havens**. Well, I suspect that the bank would respond to clear direction from the Congress that the Congress wished the statements to be presented in accordance with generally accepted accounting principles which would include a loan loss reserve. It would seem to me that that would be appropriate language for the committee report. I suppose if the Congress wished that to be made even more clear such as a mandatory requirement, it could be included as a special provision in the appropriation language itself. Which of those courses would be appropriate, I would suggest the Congress may want to discuss that with the bank.

Mr. **Mrazek**. I have several other questions here but they are not as important as the two central issues that I have asked you to address up to this point. I don't know if there are any other points that you wished to address for the record.

Mr. **Havens**. No, there aren't. We are at the pleasure of the committee. If there are other things that the committee or staff would wish to discuss separately, we would be at your disposal.

### GAO'S RECOMMENDATIONS ON LOAN LOSS RESERVE

Mr. **Mrazek**. The loan loss reserve that you were talking about, do you have specific recommendations as to what that should consist of?

Mr. **Havens**. Well, the normal practice in accounting is for the management of an entity to take responsibility for the financial statements and the auditor to be in the role of reviewing those statements—assuring that they are accurate and prepared in accordance with generally accepted accounting principles.

We think the approach to establishing the loan loss reserve should be based on a review of the portfolio of loans which the bank presently holds and an assessment of the probability or risk of noncollectibility. We think that responsibility rests with the bank, not with GAO. It would be unusual for an auditor to define what that number ought to be.

We did so with respect to the 1984 statements. We attempted to do so, and developed the range of one to one and a half billion dollars, simply to give an indication that this was not a minor issue; it was in fact a very substantial incorrect presentation of the financial statements, and therefore I would prefer not to try to estimate what that number ought to be, but rather simply to stress that it is a material issue. It is a bank's responsibility under normal commercial practice to assume responsibility for developing that amount.

Mr. MRAZEK. Well, I would certainly agree with you and I can only tell you that I for one found your report particularly illuminating and I must confess that as the most junior Member on the subcommittee I was not particularly well aware of the financial reporting practices of the Export-Import Bank. I, for one, will be working with other Members of the subcommittee to see that the same types of reporting standards that a private sector bank would be required to adhere to would be adhered to by the Export-Import Bank.

I, for the life of me, find it hard to believe that describing $47 million in bank interest to 1951 for Cuba and continuing to carry $83 million as a receivable as if it is good as a loan that one has made to an entity that would have obviously every expectation of maintaining its payments, is ludicrous. Again, I want to thank you very much for your report.

Mr. HAVENS. Thank you, sir.

Mr. MRAZEK. I would appreciate it if you would submit a copy of the 1985 audit for the record when it becomes available in April or May.

Mr. HAVENS. We will do that, sir.

Mr. MRAZEK. We call on Mr. John Bohn, acting President of Export-Import Bank.

I want to express again the apologies on behalf of the committee for your having been detained for a substantial period of time beyond when you were called to testify. Needless to say, you have been listening, I guess, to the testimony of Mr. Havens. I am sure you have read the GAO report. I wonder if you wanted to comment on that or if you want to insert your statement in the record or read any portion of the statement.

Mr. BOHN. Thank you very much. I think while it is fresh in everyone's mind, what I would like to do is make some comments on Mr. Havens' statement first, ask that my prepared testimony be included in the record, and then move on to parts of that testimony that relate to other issues before the committee.

Mr. MRAZEK. Fine.

### EXIM RESPONSE TO GAO FINANCIAL OPINION

Mr. BOHN. I think the questions that you asked, Mr. Chairman, are clearly the right questions in terms of eliciting why it is that the Export-Import Bank disagrees with the General Accounting Office, but I think there are a couple of areas where they are misperceiving the role of the Export-Import Bank.

The purpose of the Export-Import Bank by statute is to take a risk at the margin that commercial banks are not prepared to take. That is to say, in pursuit of our exports, we are supposed to take those risks as the lender of last resort which the commercial banks do not or are unwilling to take.

Second, I think one needs to look at the purpose of a capital account and the purpose of the so-called generally accepted accounting principles. One has generally accepted accounting principles for the private sector and for the commercial banking community for basically two reasons. One is to protect the shareholders, and the other is to protect those who lend money or invest in the obligations of that entity.

None of those apply with respect to the Export-Import Bank. We do not depend on the quality of our financial statements to borrow money. We undertake no obligations that are risky by virtue of anything that goes on with our capital accounts. I would suggest that is a fundamental difference between the role of the generally accepted accounting principles in the commercial banking system and what we as a government agency are all about.

Mr. Havens states, for example, that it is necessary to state all of the problems that he sees with the Bank's portfolio. I would come back to the question, why is that? Again, in the commercial area, it is to fully disclose so that people who are at risk by virtue of not knowing do, in fact, have maximum information. The Export-Import Bank does in fact disclose reschedulings in its annual reports and it states where there are problem loans, in general terms. But again with respect to the capital accounts, looking at every accounting point of view, we would submit there is nothing to be gained by doing that, and indeed there is a good deal of risk involved.

Mr. Havens states that disclosure could cause a collectibility problem. Indeed, I would endorse that. We are engaged as part of the government team at this point in dealing with assets in Mexico, Brazil, Argentina, and many other countries where the negotiations are tremendously sensitive. The impact of an action like publishing or writing off loans to those countries, or even suggesting that might be the case, has two potential impacts: one, it reduces the interest of that country in paying. Since the loan has already been written off, why bother. Secondly, since we are a government agency, it may well precipitate, a withdrawal of credit to thast country by the commercial and private sector. So there is some severe risk independent of simply the question of writing it off for the sake of good order.

I think the question that we have to point to in terms of types of loans is, are they exercising good judgment? Yes, indeed, they are. We have a staff, we have Directors whose job it is to exercise those judgments, and I would suggest to the committee that in fact those judgments in many cases are very difficult.

I don't think it is a question whether the Board is insincere or not in terms of exercising these judgments. I think we make the judgments the best way we can.

We would submit that we do in fact now put forward a proper statement of operations.

You raised the point of China and Cuba in the question of collectibility. I would venture to say that taking China as an example, whereas they are repudiating our form of government, time in the Chinese context is very different from the demand of a periodic reporting requirement established by the Accounting Standards Board. I would be willing to bet personally that by the time history unfolds itself, those particular bills will in fact be paid. But the issue of that depends on a very complicated geopolitical evolution which we find taking place right now in terms of how China's economy is evolving.

The absorption question, if you like, in Congress, the continual discussions going on relating to Taiwan, which represents the government to which, arguably, these funds were made, all of these change. And since the concern is not the time when these are paid but whether they are collectible, I would suggest that there is at least a difference of opinion that is credible in terms of whether or not these will be paid.

If in fact the Board determines at some point that they will not be paid, we will simply write them off and charge them to income at that particular point. To me, those are the two most difficult cases and the ones that tend to stick out as examples of egregious bad judgment, if you will.

I would suggest that certainly in the case of China, and I think it is at least arguable for similar reasons in the case of Cuba, it is not as if someone were going to be bankrupt—not as if a country will disappear. These are political decisions largely, and the politics of a number of countries change over time. In the broad spectrum of loans with which we deal, I think the problem are overstated. The delinquent loans that Mr. Havens talks about are basically in seven countries. China and Cuba represent roughly $50 million of that. The others are characterized as delinquent if one payment is delinquent, the entire capital value of that loan is included. I would suggest that that tends to overstate the real concerns that we have.

Those of us who have been in the international business for some time recognize that it is not quite like paying your bill at a hardware store or clothing store. It is not uncommon at all for even the best of debtors to delay payments beyond the time that they are due. For example, in the best of days when Mexico was flushed with oil reserves, PEMEX, as a matter of policy, never paid its own suppliers on time. This is just part of the international recognition, I think, that one has to have that is a little bit different.

Let me give you the other side of that, if I could. The Bank's current reschedulings represent about $2 billion. So out of the total loan portfolio of roughly $17 billion, the total that is current and has never been rescheduled represents roughly 72 percent, or $12 billion. My point, Mr. Chairman, is only that there is a broader context within which these decisions need to be made rather than that which applies strictly to the commercial marketplace and the commercial banking system.

Mr. **Mrazek**. Thank you, Mr. Bohn.

[The statement of Mr. Bohn follows:]

Statement of
John A. Bohn, Jr.
First Vice President and Vice Chairman
Export-Import Bank of the United States
Before the
Subcommittee on Foreign Operations
Committee on Appropriations
U.S. House of Representatives

March 13, 1986

Mr. Chairman and Members of the Subcommittee:

It is a pleasure for me to appear before you today to present Eximbank's budget request for fiscal year 1987.

Since its creation in 1934, the Export-Import Bank has supported more than $180 billion in U.S. export sales, helped sustain American jobs and contributed to the benefits that international trade brings to both buyers and sellers. Eximbank's purpose has remained the same since its beginning -- to help finance U.S. exports -- but the Bank's emphasis has changed many times as needs have changed.

Today, Eximbank's activities are changing once again, as part of President Reagan's program to address our international trade deficit. The President's trade policy is based on keeping international markets open on a freely competitive basis. Eximbank has performed an important role in leveling the playing field in international trade. The President, in his budget and his legislative requests, has made it clear that he wants us to continue our role in combatting unfair trade practices by foreign competitors and keeping markets open for American exporters.

Eximbank helps boost American exports in three ways. We assist American companies, which are encountering foreign subsidized competition, by providing competitive financing for their export sales. We help private lenders finance export sales by assuming repayment risks which the private sector cannot reasonably be expected to assume. And, with the Treasury Department, we negotiate with other members of the Organization for Economic Cooperation and Development -- the OECD -- to reduce unfair export credit subsidies.

As you know, the U.S. Government is pressing our OECD counterparts to raise the level of the minimum grant element in tied-aid credits from 25 percent up to 50 percent. At the President's direction, Eximbank last year began an aggressive campaign of targeted mixed credit action directed against those countries that have been impeding these negotiations.

To further our negotiations, the President has requested the establishment of a new "Fair Export Financing Program" to be administered by the Treasury Department. With a $300 million "war chest" of grant money to combine with Eximbank's regular export financing, this program could support up to $1 billion in U.S. exports. It should provide a firm push to move our OECD counterparts back to the negotiating table. We urge you to support this request.

The President has also requested legislation to extend Eximbank's Charter through fiscal year 1991 and to provide authority for a new Eximbank interest rate matching program.

FY 1987 Budget Request

The Export-Import Bank's budget request for fiscal year 1987 consists of $12 billion for guarantees and insurance, including $1.8 billion earmarked for the new interest matching (I-Match II) program. We are also requesting $19.175 million for administrative expenses.

The I-Match II program that we are proposing as a replacement for our direct lending is an improved version of the program proposed a year ago. The program is designed to make major budgetary savings. At the same time it will increase opportunities and incentives for private commercial banks to become more involved in the financing of U.S. exports. It would do this with no loss of competitiveness to U.S. exporters.

Under the enhanced I-Match II program, the private sector would finance fixed-rate export loans at minimum OECD Arrangement interest rates where necessary to meet officially subsidized foreign competition. The foreign buyers will repay the loans at the OECD interest rates. Eximbank will pay the lending institution any difference between the OECD rate and the competitive market rate.

Since the loans are being made by the private sector and serviced by the private sector, with Eximbank exercising only its guarantee authority, we agree completely with the position taken by the Office of Management and Budget on the scoring of I-Match II. Guarantee authority by definition in the Budget Act is not calculated as budget authority. Scored on this basis, it's estimated that this new program will save $4.6 billion in budget authority and $1.9 billion in outlays over the period 1987 through 1991.

Under the enhanced I-Match II program, a broad section of the financial community has indicated that they will make these loans, with our guarantee. We listened to the concerns that the financial institutions raised last year, and in developing I-Match II we are addressing those concerns. We invited bankers from both the trade finance and the capital market side to give us their views. These ideas have been incorporated in the development of I-Match II.

In addition to working closely with bankers, we sought the advice of a wide range of exporters and incorporated their suggestions as well. I think that we have demonstrated to their satisfaction that I-Match II is technically sound.

The Bank's direct lending program has played an important role, in offering American exporters the below market, fixed-rate medium- and long-term financing that they need to meet officially supported foreign competition. The same support will be available under the I-Match II program.

We are requesting I-Match II authority to support private sector lending at consensus rates of up to $1.8 billion in FY1987. In FY1985 Eximbank direct credits, medium-term credits and small business credits totaled $660 million. A major reason we used only a small fraction of our total FY1985 authorization was that those exporters who traditionally needed the Eximbank long-term lending were more and more frequently turning to the private sector to finance their foreign sales.

The reason for the shift, I believe, dates back to 1983, when the international arrangement on export credits pegged export credit agency interest rates to market rates, with adjustments every six months. Interest rates turned down sharply in FY1985, so for most of the months of the year, market rates were actually well below the consensus rates, which are set in January and July, and remain unchanged for six months.

The more favorable market rates help explain the results of an analysis we did of the $4.1 billion in orders awarded by foreign buyers during FY1985, where Eximbank had offered direct credits to U.S. exporters.

Of this total American companies captured 51% of the business, valued at $2.1 billion. That batting average is in itself amazing considering the high value of the dollar and other factors impeding U.S. exports during this period. But even more surprising is the fact that of those orders, $1.8 billion, or 85%, were financed in the private sector. Some were supported with the Eximbank financial guarantee, but without Eximbank lending, even though we had offered OECD minimum rate financing.

In each case where the U.S. exporter loses an order for which an Eximbank offer had been extended, we ask them why they lost. It is true that some exporters may not get an order because we won't extend credit to certain customers or in certain countries, either because we are precluded by law, or we cannot find reasonable assurance of repayment as required by law. But in all the cases where we did have an outstanding offer, no orders were lost because Eximbank was not competitive with other export credit agencies' standard financing. The lost business was attributed to price and other commercial considerations, or foreign mixed credits.

Eximbank is working steadily to improve its programs to make them more accessible. At the same time the dollar is dropping, making our exporters more competitive in world markets. So we expect to see an increase in demand for all our programs.

We are promoting our programs in many ways, with both exporters and banks. The banks are very important to us, because we rely on them to bring applications to us in our medium-term lending and guarantee programs and our Working Capital Guarantee Program.

In the Working Capital Guarantee Program we took a very significant step by extending delegated authority to banks nationwide. This allows qualified banks to commit Eximbank's guarantee on working capital loans to small businesses by accepting a risk participation of 15%. The concept of delegated authority in this relatively new program was first tried out in our Four-State Test Marketing program.

We expect this will introduce many more small banks to Eximbank and its programs. As you know, there are some 14,000 banks in this country, but few of them have shown any interest in export financing. They are generally unwilling to accept foreign risk. They don't have the requisite international expertise that is currently the province of the major money center banks and large regional banks. But small banks do make working capital loans to small businesses in their communities, and where these are export related, we are willing to assume the lion's share of the risk. The next step is for them to insure the payment of export receivables through our agent, the Foreign Credit Insurance Association. And as they offer export related services, they'll begin to attract new customers. Here's an example of how it's really working. "Eximbank helps firm jostle the giants," reads the front-page headline in the Aberdeen, Washington World. The story is about an Eximbank guaranteed $750,000 working capital loan that the Bank of Gray's Harbor extended to T. J. Spradlin, Inc. Spradlin is a timber firm employing around 100 people.

Stories like this -- real examples of how Eximbank is helping small banks and small businesses around the nation -- serve as vital encouragement for others to approach us. In our efforts to bring in more small banks we have written feature articles for regional banking publications, such as Texas Banking, Western Banker, The Southern Banker, and Illinois Banker. These articles all have the same general theme as the cover story in the December 1985 edition of Independent Banker: "How Can Eximbank Help Small Banks?" Independent Banker goes to the 11,000 smallest banks in the country, a territory we are actively marketing.

Since our marketing division was formed early in FY1985, members of its staff have called on 233 banks in 20 cities, explaining to individual banks how they can participate in our programs. They've held field seminars in seven cities, attended by 425 bankers from 209 banks. They have held 12 intensive four-day seminars at Eximbank, which were attended by 238 bankers, representing 115 banks, of which 48 are new to Eximbank. In addition, 181 banks have gone through our certification process to become qualified users of our programs. We refer exporters calling in on the Business Advisory Hotline to certified banks in their area. And these banks advertise this certification in their own marketing programs.

In FY1985, 167 banks used one or more of Eximbank's programs. Ninety-three were involved in our medium-term credit and guarantee programs. In FY1985, for the first time, our medium-term lending authorizations, including our small business credits, were greater than our direct credit lending.

At the end of the first five months of FY1986, medium-term loans accounted for about 65% of our lending activity. By the end of February, we had authorized loans of about $280 million, or around one-quarter of our FY1986 limitation.

Business is picking up. Within the next few weeks exporters will be in to convert some outstanding preliminary commitments into actual authorizations because they have recently won the orders. General Electric has won a $100 million order in China and an $18 million contract in India. Both will require Eximbank financing. The same goes for a $27 million contract Control Data has won from the French in India with our mixed credit financing offer. Island Creek Coal will need our financing for a $107 million order they've won in China.

All these orders we now consider to be 100 percent certainties. In forecasting demand for our present direct credit program, we do a running probability analysis on all the preliminary commitments we have outstanding. Right now we have about $5 billion in outstanding preliminary commitments; that is, offers to finance projects and products if the American supplier gets the business. In consultation with the U.S. exporter, we estimate the chance of a U.S. supplier getting the order, and the chances of the order being placed in the current year, and in the next fiscal year. We also try to determine whether it will require a loan, or can proceed with a financial guarantee. We are constantly reviewing and updating these estimates.

For FY1986 we have already authorized Direct Credits of $99 million, and our projected demand for the rest of the year is $772 million. This figure includes $297 million for orders already received by the American supplier, but where the loan has still to be authorized. This projection would put direct credit demand at about $870 million in FY1986. We estimate our Medium-Term Credit Program and Small Business Credit Program will use around $360 million in budget authority during the year. These are smaller orders, and our projection is based on historical experience.

This suggests a total credit demand of about $1.23 billion for the current year, which exceeds our present limitation of $1.062

billion, and means we would have to accommodate the excess out of our FY1987 budget.

Our probability analysis of specific, identifiable FY1987 business, at this point, over a year and a half away from the end of FY1987, shows long-term credit demand for specific projects known at this time of $416 million. Combined with the projected medium-term demand and the carry over business, this brings us to about $1 billion already, before taking into account new long-term business that will develop over the next 18 months. Adding this element of demand, we believe demand will total $1.8 billion for Arrangement rate credit support for FY1987.

These estimates have been prepared on a very conservative basis. They assume no direct lending or I-Match support will be needed to finance aircraft sales in either FY1986 or FY1987. They do not factor in the possibility of nuclear power plants going forward in either year.

In 1987, lower oil prices and lower interest rates are expected to result in increased demand worldwide. We will continue to see the effect of the increased competitiveness on the part of U.S. exporters resulting from increased efficiency, cost reductions, and the weakening of the U.S. dollar. Given a 12-18 month lag for exchange rate fluctuations to affect export orders, the accelerated fall in the dollar should result in higher U.S. win ratios in FY1987.

We would also expect a higher win ratio to result from mixed credit offers made in conjunction with the "war chest" program.

Although many countries in Africa, Latin America and the Middle East are suffering from debt crisis and slow economic growth, we see stronger demand emerging in FY1987 and beyond in countries which are key markets for U.S. exporters. In Asia, China, India, Korea and Taiwan are planning growth rates in the 5% range and U.S. exporters are targeting these markets which still rely on export credits at OECD rates.

Development priorities remain high in these key markets in such areas as electric power, telecommunications, transportation (locomotives and aircraft) and development of their own energy resources of coal, gas and oil. U.S. exporters are targeting these sectors and will need Eximbank support to offset the credit subsidies offered by other governments.

Insurance and Guarantees are becoming increasingly important for Eximbank. In FY1985, we used $7.85 billion of insurance and guarantee authority to support $8.7 billion in U.S. exports.

For 1987 we are requesting a $12 billion authorization limit, of which $1.8 billion will be earmarked to guarantee the I-Match II commercial lending.

The administrative expense budget of the Bank provides funding for personnel, support services, and operating expenses. For FY1987, the Bank is requesting $19,175,000 for administrative expenses which will support a full-time equivalent personnel level of 339. This is the same personnel level as FY1986 and 82, or 20% less than 1980.

The requested level of $19,175,000 is an increase of $818,000 over the FY1986 limitation of $18,357,000. However, $400,000 of this increase is Eximbank's share of a one time charge for the installation by GSA of a new phone system in the building. Without this one time charge, the increase in administrative expenses in FY1987 over FY1986 is only $418,000, or a little more than 2%.

Of the $19,175,000 requested, $13,814,300 (72%) is for compensation and benefits and $1,793,100 (9%) is for rent of office space. Travel is budgeted at $400,000, an amount that is less than actual travel expenses in FY1985. $75,000 is budgeted for marketing assistance which will be used to help reach new exporters, especially small businesses. As I mentioned, $400,000 is for the one time charge for the telephone installation. $16,000 is for official reception and representation expense. The remaining balance of $2,676,600 is for necessary operating expenses such as equipment rental, purchase of supplies, printing and reproduction, and other service contracts. I should also note that we are devoting funds from many categories to install a real-time computerized management information system. This will upgrade the quality and timeliness of information vital to making management decisions.

There is one other financial matter I would like to address here today. It relates to the Bank's Reserves. At the end of FY1985 the Bank had $1 billion in capital, and just over $1 billion in retained earnings. Our reserves have been declining for the past few years. This is mainly due to net operating losses incurred because interest rates on loan commitments made in the late 1970s were much lower than the cost of funding such loans. However, in addition to these losses, the Comptroller General believes that the Bank should establish a special reserve for loan losses on sovereign risk loans. We do not agree with the Comptroller General's position.

Since our inception in 1934, Eximbank has consistently followed a practice of writing off loans only when the Board concluded they were uncollectible. Most of our portfolio is made up of sovereign risk loans. The Bank is extremely cautious about writing off loans to government obligors and guarantors because we believe these sovereign risk loans ultimately will be repaid. Moreover, full disclosure about rescheduled and non-performing loans has always been provided in Eximbank's financial statements.

We have always considered our entire retained earnings to be a "Reserve for Contingencies and Defaults." Our position is supported by the Treasury Department and other agencies such as the State

Department and the Federal Reserve Board. Our treatment of these loans was also accepted by the Comptroller General until FY1983.

In conclusion, I believe that Eximbank now has a broad range of competitive export financing programs to help boost U.S. exports. The Administration has proposed new legislation to meet the new challenges that lie ahead -- extending the Bank's charter, providing authority for a new Eximbank interest matching program, and creating a new Treasury Department "Fair Export Financing Program" to combat foreign tied-aid credits. We have requested a budget that will enable us to provide the support our exporters need, with more private sector participation and less of a draw on Government resources.

Thank you very much. I will be pleased to answer any questions.

## TIMELY REPAYMENT OF EXIM CREDITS

Mr. MRAZEK. I wonder if you would comment on what the impact might be on those nations that do in fact make regular timely payments back with interest on existing loans to the Export-Import Bank, if they thought that, hey, let's just act like China and say that we are in a different geopolitical evolutionary context and that in the year of the mouse in the 23rd century we will decide to begin repaying those loans.

And, gosh, somewhere down the line somebody will be able to say a couple of hundred years from now, you know, Mr. Bohn, when he testified before the Foreign Operations Subcommittee of Appropriations, was right, no one ever expected China to pay that loan, but they did. Isn't that going to have an impact when Cuba repudiates loans, and they are carried for 35 years as just good debt? How does that impact on other nations that are making a sincere effort to repay? Doesn't one try to make an example out of nations that are bad debtors?

Mr. BOHN. Well, I think there are two points there. The direct answer to your question, I would suggest, is that the impact in terms of example is really very limited. The reason for that is if a country simply repudiates debt and refuses to pay, we simply stop providing funds for that country. It is not only because we do it but the entire commercial international financial community simply stops making loans available. We have seen that in a couple of cases. Again, China is a more difficult case.

Mr. MRAZEK. They are coming in now for World Bank money.

Mr. BOHN. That is absolutely correct. But the broad spectrum of the decision making process is really a question of trying to draw a balance between what a government is prepared to do; a country has a sovereign right to repudiate debt if it so chooses. It is also the sovereign right of the creditor not to provide any more funds. I suggest that is a very different policy consideration, based on your question, than whether for the sake of some order we change how it is expressed in the financial statements.

My thrust goes back to the issue that we are dealing with here, namely, whether or not this is an adequate presentation, not how we manage when we disburse funds to a country which has repudiated its debt. Again I come back to the proposition that the concern of Congress, and our own concern, is really whether or not the Bank's financial statement provide an adequate, forthright picture. So Congress can provide the oversight that it indeed must and should. I would suggest that they do. We deal all the time with situations where countries are delinquent, where they are behind in their payments, or where they are simply rescheduling.

All of this is simply a fact of our everyday life. We shut down in a country the other day because they have simply said they had no intention of paying. If one has no intention of paying, it seems to me we have no particular intention of providing more funds. They will discover, I suggest, Mr. Chairman, in the not-too-distant future that the course of action they have undertaken is simply impossible. They will not be able to follow that course, because the country will bankrupt itself, will simply be unable to proceed at some moment in time. Then their existing stock of debts will be dealt with, rescheduled, and I will suggest that payments will resume.

### ADEQUACY OF EXIM BANK ACCOUNTING

Mr. MRAZEK. Well, I must confess that as a layman, I find that GAO seems to make a fairly effective case, that when you have loans that have been repudiated and where no payment has been made for 35 years, that that loan ought to go into some type of problem debt area, that it not be treated exactly the same way as a debtor nation that is continuing to make a sincere effort to pay back its loans with interest.

At least to that extent, it would seem to me that they have made a very effective case and that when a rosy picture, a relatively rosy picture of $1.4 billion in retained earnings, as of September 30, 1984, is presented to Congress, that the picture isn't as rosy as one would like to believe. It would appear that a lot of banks that have lent money overseas are in trouble now and are looking to the Federal Government, in the event that those loans do become bad debt expense, for assistance and support.

When the bottom falls out of the market for oil, and Mexico is carrying a huge debt to the United States of America, and to many banks which lent Mexico money, at rates which would be considered usurious if they attempted to loan at those rates in the United States, I can understand that it is a very sensitive problem because the amounts of money are so vast that an awful lot of banks would be in a great deal of financial difficulty if those loans had to be written off.

I think that our responsibility on this subcommittee is to see that the Export-Import Bank, which is financed by the United States Treasury, maintains a responsible approach which I have no reason to doubt is being maintained in terms of the quality of the loan portfolio that you are continuing to handle, but where we have a very clear capability of understanding and appreciating how good a financial shape the Export-Import Bank is really in.

Mr. BOHN. Well, certainly, Mr. Chairman, I agree with that. Part of the difficulty, I suggest, is the question of whether the financial statements, by the way they are kept, do provide an adequate capacity for oversight. I think they do. My concern, as yours, Mr. Chairman, must be the capital position of the Bank and there is no inherent legal or other reason which would require capital to be maintained at any particular level. It is nonetheless for management purposes the most efficient way to manage and in fact report to others how in fact we are doing, what kind of risk we are taking, and what kind of costs this represents to the taxpayer. That is of concern to us and a concern of Congress.

We are looking at the capital account and we will, I suspect, be back ourselves with a proposal as to how to deal with this situation of declining reserves. We are concerned that the financial statements provide an accurate picture as far as oversight is concerned. It is not quite as simple as going in for recapitalization. As you know, we are required to report when our reserves reach, I think, $356 million, which we estimate now will be the first or second quarter of 1988. We would hope to have a plan sometime this year or early next year, well in advance of that date, whereby Congress will have an opportunity to decide what, if anything, it wants to do.

Mr. **Mrazek**. I take it, then, that based upon the analysis of GAO, you are not automatically accepting the strengths of that report and following their recommendations?

Mr. **Bohn**. No. We think that our financial statements do in fact reflect the Banks financial situation, and we believe that not only we understand but that Congress and other oversight agencies do understand what it is that we are doing. We recognize the problem of deterioration of capital. That is clear. Whether we report our loan losses on a cash basis or on an accrual basis is less important than the fact that we deal with the Bank's deteriorating reserves, which we intend to do.

I don't think, however, Mr. Chairman, that to go through the exercise of trying to adhere for essentially, I would submit, the wrong reasons to generally accepted accounting principles which are designed to deal with the commercial banking community, and both the depositors and shareholders rely on that really is the answer to the reserve problem which I believe is far more important and of a greater concern to the committee.

### I-MATCH SCORING

Mr. **Mrazek**. In respect to the I-match II program, apparently the CBO is on record as requiring that that program be scored in the same manner as the Export-Import Bank direct credit and guaranteed loan program is scored. If this is in fact going to be the case, what advantage does it have over the present program since GAO suggests that it is actually more expensive to move toward that type of subsidy approach?

Mr. **Bohn**. Well, I saw that stated in the GAO statement. It is less clear to me that the CBO in fact has made that final determination. I have been trying to ascertain whether or not that is the case. I know in some testimony a few weeks ago it was indicated pretty strongly that that would be their view. However, in some subsequent conversations, based upon some modifications Exim made to the I-match procedures, it is less clear that that is their final position.

I honestly don't know the answer to that. We maintain that our interpretation and that of OMB is the correct one. What they are concerned about is the possible impact of that scoring in terms of Congressional control over the budget. But they seem to concede, at least implicitly in their statement, that as a matter of fact guarantees are different than loans, and we submit that the I-match our guarantees are a derivative of the Bank's existng guarantee program, and whereas the guarantees may look like loans, indeed they are different animals.

One finds the difference between guarantees and loans in the financial business generally, and our interpretation of the distinction as contained in the law would lead us to believe the CBO is taking the extreme view of guarantees rather than that of loans. We simply think CBO is incorrect.

Mr. **Mrazek**. If they proceed to go on record as formally requiring that scoring on the budget, would this program represent an advantage over the present system?

Mr. **Bohn**. Well, I think there are two elements of that. There is clearly a cost difference. That is to say, I think they outline, at least collectively, the cost difference, a difference in our cost of funds and incremental cost it would take us in terms of interest makeup.

I would suggest that there is a different, perhaps more valuable benefit to be obtained from the I-match program, even if it is scored as you suggest CBO might do—that there are some advantages to the I-match program.

One of the problems that we see most clearly is the unwillingness of the commercial banking system to deal with requests for medium-sized loans in the trade credit area. Having been a banker myself, having managed this kind of department, I know what happens when you try to bring a trade credit to the credit committee. They tend to be heavy workload kinds of credits, which particularly a small or medium-sized bank does not, typically have, the capacity to assess. Indeed, that is what our role is.

The I-match program, as presented, couples our full-faith guarantee with limited transferability. That is to say, what we have tried to do is to bring the banking system back into supporting trade credits. The very large companies who are heavy users of the Export-Import Bank know where the Export-Import Bank is, they know how to access it. Our concern is that there are other banks and there are other exporters around the country who simply need to be able to access their banks in support of exports, and our hope is that by adding to the program our full guarantee plus making that guarantee transferable, you then meet another need of the commercial banking system, namely, the need for liquidity.

Rather than having to hold on to that piece of paper, the bankers now are very concerned about being able to be liquid. By providing an I-match program, getting the banks back, giving them this sweetener, if you will, we believe that in the long term that is going to be far more beneficial to the exporting community than otherwise would be the case. We have talked to the capital market group of banks. In our judgment, this is a program which is not only workable but, indeed, quite attractive to the banks. It does cost more in the one sense. I would suggest that is the price you pay for trying to bring the banks back into support of exports.

Mr. **Mrazek**. I might suggest that if it is scored as CBO requires, I don't think the House is going to approve it or Congress is going to approve it. We are going to be voting on the President's budget in a little while. Who knows, it might be approved. What will you do if it is approved?

Mr. **Bohn**. The President's budget is approved?

Mr. **Mrazek**. I don't think he has asked for any money for you, has he?

Mr. **Bohn**. There is no request for direct credit. The request is for $1.8 billion in the I-match program. That is the President's request.

## ESTIMATED DEMAND

Mr. **Mrazek**. So we could be in an impasse if it is scored as CBO requires.

In the direct loan guarantee program, let's assume that I-match is not considered by Congress to be an effective alternative, for one or another reason. What do you think would be a fair amount for the Export-Import Bank in direct loan guarantees or direct loans?

Mr. **Bohn**. Well, this is a very difficult question, as it is every year. As you know, we have missed it substantially over the last three or four years. Our estimates have been much higher than in fact what has turned out. There are a number of reasons for that. Part of it is the high dollar, part of it is the debt situation in a number of these countries we were talking about earlier.

A lot of the projects which would normally consume direct credit have simply been deferred. What we tried to do in making our request for the $1.8 billion, is to estimate as best we can a couple of different ways in order to come up with a number that represents what our best judgment is for demand in FY 1987 for arrangement rate financing. For fiscal year 1986, we are estimating that our total demand for loan authorizations will be $1.2 billion.

As you will appreciate, that is over the $1.1 billion that we are permitted under the Gramm-Rudman reductions. So my guess is that we will start 1987 with about $160 million or $170 million of credit which will have been deferred from FY 1986.

Our Medium Term Credit Program, which is the one that is typically accessed by most of the small and medium-size business, capital goods exporters and the rest, has been growing very substantially. We estimate that that should amount to roughly $400 million in 1987.

Now, in the past we have estimated demand two or three ways. We have looked at the trends in exports for sectors that we have traditionally supported, such as telecommunications, and others. When those numbers are run this time, the result is somewhere between a $1.3 billion and $1.4 billion. We also looked at demand in terms of the various economies which have traditionally been recipients of U.S. exports, supported by Exim. We have estimated demand by geographic area. For Africa and the Middle East our guess is that somewhere between zero and $20 million is a fair estimate as to what is going to be authorized.

The demand for fixed rate credits for Latin America we figure is somewhere between $290 million and $390 million. That depends a lot on whether Brazil and Mexico and Argentina can continue to make progress in terms of their debt adjustment. If they can't, the demand is not going to be that high. Our estimation is that at least two out of three will in fact make substantial progress, so some Exim supported exports of goods and services will go forward in those countries.

In Asia we have estimated demand at between $245 million and $345 million, and our guess is that that represents really a timing question. Clearly, the demand in China, India, Indonesia and those countries can be enormous, but there is a lag time between the time those deals are first known and the time we actually get a request for a loan authorization. So our question is not whether there is going to be demand, the question is really the timing. So we get to, as I say, between $240 million and $345 million.

In Europe and Canada, we estimate demand at between $40 million and $60 million. That depends largely on the competition.

So if you add all of those together, and you add to that total the cases for which we now have preliminary commitments outstanding, and those for which we now have requests in house, which amount to $416 million, we get to $1.8 billion.

Now, you will appreciate that there is a lot of speculation and many of judgment calls in this. This is our best judgment. We tried to make it conservative this time by not including any money for aircraft because the marketplace now tends to be able to finance aircraft cheaper in the private market with our guarantee than the arrangement rates for Exim direct loans. This is a result of the new aircraft agreements. Rates in private financing typically have been lower for aircraft.

Mr. **Mrazek**. It will no longer be called the Boeing program in the future?

Mr. **Bohn**. I hope not.

For example, we made I think $450 million of direct loan preliminary commitments for aircraft last year, and not one was taken up. Our guarantee was used. In sum, it was cheaper for them to finance in the private market. We have included no aircraft deals in our estimates for 1987.

There is a likelihood that some may crop up, but we decided to be conservative in our estimates. We have not included any nuclear for 1987. Even though we expect to have in-house at least one, if not two, nuclear requests, we don't think in those years they are going to come in for final authorization, or at least not much of it is going to come in for final authorization.

We have not included any direct credit for these types of cases, which can be fairly large ones, because for financial reasons, it is better for them to use private credit. But that is how we get to the numbers, and it is admittedly a judgment call. We have tried to look at the situation two or three different ways and come up with our best judgment.

Mr. **Mrazek**. It looks like a pretty careful deliberative assessment, and I fully appreciate the need and importance for the Export-Import Bank. I want to be sure to go on record as making that clear. I will now call on Mr. Porter to chair this hearing.

## MOROCCAN PHOSPHATE MINE PROJECT

Mr. **Porter** [presiding]. Thank you, Mr. Chairman.

Let me ask some questions about how you decide in granting loans, the advantages and disadvantages of doing so. Let's take as an example the loans in support of Caterpillar, and I think it is G.E., for work in rebuilding the phosphate mines in Morocco.

Presumably this is very important to those companies that receive that support, very important to the Moroccan government in that sense as well. But what about the negative side of that kind of a loan; do you look and see how that affects other American companies in what they do in terms of competition? Is that a consideration in making a loan?

Mr. BOHN. Yes, indeed, it is. I think you phrased the question exactly the way we try to look at it. We ask a couple of questions. In the first place, is the project sound and is the borrower creditworthy, which is at the root of the decision. We have a very elaborate procedure, which we call the adverse impact procedure, by which we try to ascertain to the extent we can any negative impact on U.S. companies or employment which is apt to take place as a result of supporting that particular export.

As you know, the phosphate industry has been both articulate and consistent in their concerns about oversupply and those kinds of things. One of the questions that is at the root of it is if we don't support the exporter, is the export likely to go forward from some other source—from the French or from the Japanese or somewhere else—and in most cases, certainly the case that you cite, but also in most cases, the answer to that question is yes. We simply no longer have a monopoly of that kind of equipment in the marketplace.

If it is the case that we believe it will go forward, we see, generally speaking, very little reason to have two negative impacts on the U.S. economy as opposed to one. We see no reason to penalize the exporter when it will not benefit the company or the sector which is adversely impacted.

Some of these decisions are very tough and we try to get as much information as we can. As a matter of fact, we have just adopted a new procedure about a month ago, after wrestling with this for some time, whereby we regularize that inquiry process by sector, trying to get sensitive sectors and industries identified, having them come into the Bank and having various experts try to help our staff decide what the impact is, and whether or not our judgment as far as whether there is competitive goods from other sources is correct. That is basically the way it works.

Mr. PORTER. How long are the commitments made, or the commitments made in this case to Caterpillar and G.E., how long would they continue for?

Mr. BOHN. Well, the typical preliminary commitment process is six months. At the end of that six-month period, the commitment will expire, but the exporter can come in and request an extension, which is quite usual.

Mr. PORTER. This one I think has gone for five years?

Mr. BOHN. That sometimes happens.

Mr. PORTER. Is that possible?

Mr. BOHN. It sometimes happens from the first application point to final disbursement. Often in those kinds of situations, either there has been a significant problem with the borrower and the project has been deferred, if the company is known to be less anxious to continue in the bidding process when they come around again, or the borrowing country is not very efficient in terms of processing the orders. That is the usual situation.

Mr. PORTER. Maybe we can ask this specifically. What effect have the budget cuts of this fiscal year had on that kind of commitment? Do you have specific information on this loan?

Mr. BOHN. I don't have any specific information on this loan. We can certainly——

Mr. PORTER. Could you put that in the record?
[The information follows:]

The Eximbank credit in this case would be extended to Office Cheriphien des Phosphates (OCP), Morocco's national phosphate company. The equipment would replace machinery in several of OCP's mines which is wearing out, and would maintain phosphate production levels rather than increasing them.

The credit would support the export of American mining equipment by Caterpillar and WABCO with a total value of $12.4 million. The contract was won against competition from Japan, Canada, Sweden and the United Kingdom, and in Eximbank's judgment OCP would have purchased the equipment from one of those countries had there been no offer of export credit financing from the U.S.

The two U.S. suppliers would participate in the financing by arranging a loan for 10 per cent of the U.S. Costs at Eximbank's interest rate (10.7%), with a guarantee by Eximbank covering the suppliers' portion. The Eximbank credit would be for 75 per cent of the U.S. costs, with the supplier paying cash for the remaining 15 per cent.

The Preliminary Commitment was approved on April 30, 1985. The final authorization of the Eximbank credit and guarantee was on December 19, 1985. The legal documentation is now under preparation.

Mr. PORTER. When you have substantial cuts in these loans, in order to be renewed, what do you do?

Mr. BOHN. Well, we have been either fortunate or unfortunate, depending on where one starts—we haven't had that problem. We have had surplus capacity certainly since I have been in the Bank, and I think over the last four or five years. That really hasn't been an issue. What has been an issue in these kinds of cases has been the dramatic change in the circumstances of the borrower or the borrower's country.

Our preliminary commitments are simply that. They are essentially letters of intent, which say that all other things being equal, we will provide this much money on certain terms and conditions. It is a rare situation, usually countenanced by revolution or some significant economic event, where those preliminary commitments are not subsequently converted if the Bank is requested to do so.

### DECD GRANT ELEMENT

Mr. PORTER. Recently a company from my district, Brunswick Corporation, lost a Costa Rican refinery contract worth $400,000 to a Dutch firm, Two days before the contract, Brunswick's competition came up with a Dutch government loan that the Department of Commerce rated over 60 percent conventional. I noticed in your statement that we are trying to raise the minimum grant element in tied credits from 25 to 50 percent. While I strongly support that, what is being done for companies faced with a situation like Brunswick's?

Mr. BOHN. Congressman, this is one of the most difficult issues we face and one which really has not, in my judgment, been addressed directly yet in any part of government. The proposal to raise the grant element to 50 percent is an attempt to distinguish between what is legitimately an aid transaction and what is legitimately an export transaction. My statement indicates that we are trying to get the grant element up to 50 percent. What that means is—I think this is perhaps not fully appreciated—what that means is that any grant element in excess of 50 percent will be considered aid and we will not be involved.

Now, that obviously leaves the Brunswick Corporation, and companies similarly situated, in a very difficult position, because this government has not made a decision that it will support exports per se with government funds. Other governments do in fact use their aid funds to support exports. I give you the Japanese as an example. But the discussions to which I refer to raise this grant element is attempt to make it so expensive that there will be little of this business bought at the margin. The case that you posit is not addressed, and it is a very difficult issue.

Mr. **Porter.** I have some other questions I would like to submit for the record, Mr. Chairman, and thank you very much.

[The following questions from Mr. Porter, and answers thereto follow:]

### BRUNSWICK CORPORATION

Mr. **Porter.** Brunswick expects that it will face similar situations across Latin America. In your statement you mentioned that Exim began an aggressive campaign of targeted mixed credits. Would this program be able to help companies in this situation or are they powerless to respond if the grant the Dutch government falls above the 50% level?

Mr. **Bohn.** Eximbank's aggressive program of targeted mixed credits was instituted in September 1985 in anticipation of passage by Congress of the Administration's requested $300 million mixed credit "warchest" legislation and appropriation. The purpose of the proposed warchest is to aggressively target those OECD countries that have stood in the way of successful negotiations in the OECD to substantially increase discipline over the use of mixed credits for commercial purposes. Eximbank considers mixed credits with a grant element above 50% to be true aid and would not match such an offer from other countries.

### WAR CHEST

Mr. **Porter.** Which countries would be the chief targets of the so-called "War Chest." Which industries are most effected by mixed credits?

Mr. **Bohn.** The targeted countries have been France, Italy and Belgium—and not the Netherlands. These countries tend to use low-grant element mixed credits for competitive purposes primarily in the transportation, communications and power fields.

Mr. **Porter.** Why would this war chest come under the Treasury and not the Eximbank?

Mr. **Bohn.** The proposed "warchest" would be administered by Treasury since Treasury has the primary responsibility for the OECD mixed credit negotiations, and the purpose of the warchest is to bring pressure on those negotiations.

### AUTHORIZING COMMITTEES

Mr. **Porter.** Last year the authorizing committees did not approve administration's I-MATCH interest subsidy program to replace the direct loan program. Is there any indication that they now favor I-MATCH?

Mr. **Bohn.** We believe that there may be some sentiment in the House Banking Committee to authorize a pilot I-MATCH Program.

Mr. **Obey** [presiding]. Thank you. Let me apologize for not being here. I had to be in three places at once. It doesn't work very often.

I don't really know what has happened here in terms of which questions have been asked and what issues have been pursued, so let me raise one and we will let it go at that.

### ANGOLA

Frankly, I am having a little trouble figuring out what our direction is, what the direction of the administration is in Angola. I certainly don't agree with any efforts to provide Mr. Savimbi with some running-around money, but I guess I really question whether or not the Export-Import Bank should be funding loans for business expansion in countries like Angola if the administration's official position on Angola is that we ought to be supporting somebody who is not in power there.

I don't defend the administration position but I have a difficult time figuring out how we can be going in several directions at once on that issue. Could you explain to me, because I am not fully familiar with it, what the level of the Export-Import Bank support has been and is for the expansion plans of Gulf Oil Corporation and its successor, Chevron-Gulf? Are you planning to provide additional funding through the bank this year or next year?

Mr. BOHN. The loan number is roughly $130 million, representing four loans in support of the oil business. We haven't done any business in that sector in 1985, and as far as I know, there are no requests at this point. On the general case of Angola, it is a rather peculiar situation. If I could, I would like to comment briefly on it.

Mr. OBEY. Sure.

Mr. BOHN. As you know, our task is to provide support for exports. Under the Chafee amendment, we are not supposed to take political issues into account, and indeed under the legislation which applies in this case, Angola is not defined as a Communist country. I think there is a certain wisdom in the legislation making a distinction between economic and political considerations because I think it represents a quite correct belief that foreign policy changes and governments change. If we are going to provide support for business for a continuous period of time. business, to the extent it can be, ought to be somehow insulated from these changes. We have asked the State Department on whom we rely for these determinations, and the State Department continues——

Mr. OBEY. Excuse me for interrupting. Let me simply raise a question about that assumption. What that seems to imply is that somehow our Army has to worry about what our political relations with the country would be, every department of government has to worry what our political relations are with another country, but somehow business investors in another country don't have to worry about whether their investment is consistent with American policy.

I happen to think that our policy in Angola is screwed up. But I would like it if we had only one policy at a time, and I guess, I think that the implication of your response indicates that you think that somehow the business investments have to be able to ride above it all. I think it is a legitimate question as to whether or not we ought to cut back on our relationship with a government which we are trying to cultivate for certain other regional reasons. At the same time, if that is the policy of the government, I don't see why a branch of the government ought to be encouraging investments in a country when the administration is clearly unhappy about that.

I don't take that view with regard to multilateral institutions, because certainly there are other American interests which are served by the function of most multilateral banks that are far more important than our temporary relations with any country when it comes to an operation such as the Export-Import Bank.

I guess I have a lot of trouble understanding why American government policy should take a back seat to a business investment especially when we are being requested to underwrite that business investment.

Mr. BOHN. I think that is a perfectly fair point, Mr. Chairman, and let me try to restate it. I think what I am saying is that Export-Import Bank in support of——

Mr. OBEY. Are you telling me that your interpretation is you are precluded by existing law from declining to fund a loan in Angola?

Mr. BOHN. Well, the legislation, as we read it, does in fact do just exactly that and it goes beyond, because it assigns to a different part of the government, rather than Export-Import Bank, that decision. It assigns to the President who has delegated the authority to the Secretary of State who has custody of our foreign relations, the task of making that decision. What the legislation seems to say to us is that these agencies have determined that in their judgment, rightly or wrongly, we should continue to provide funds for creditworthy projects in Angola.

I think, rather than us taking the position that we should make the decision, I would say that we probably have less capability of deciding what our national policy should be than the State Department and the executive, and we are essentially caught——

Mr. OBEY. I am not trying to chew on you.

Mr. BOHN. I understand.

Mr. OBEY. I am trying to figure out what is going on.

Well, I have two other questions on that score I would like to ask you for the record, and just one other question and we will call it quits.

[The following questions from Mr. Obey, and the answers thereto follow:]

### EXPORT-IMPORT BANK LOANS THAT BENEFIT ANGOLA

Mr. OBEY. The operations of the Chevron/Gulf Corporation in Angola's oil-rich Cabinda province account for as much as 75 percent of Angola's oil exports. Angola's total oil export as a whole are thought to provide approximately 90% of the country's foreign exchange.

Export-Import Bank loans that have financed Gulf's expansion plans in Angola over the years are a particular source of contention at the present time. Senator Proxmire and Representative Hunter have introduced nearly identical bills (S. 2049 and H.R. 4145) to prohibit such loans.

Can you review the level of Export-Import Bank support for the expansion plans of Gulf Oil Corporation and its successor, Chevron/Gulf, in Angola? Will additional funding be provided through the Bank in FY 86 and FY 87?

Mr. BOHN. Eximbank has authorized $228.9 million in loans and financial guarantees in support of the oil sector in Angola. These amounts are secured by off-shore escrow accounts into which the proceeds for the oil liftings placed to service the debt (for SONANGOL, the state oil company 51% portion of the financial amount) or have Gulf Oil Corporation as guarantor or obligor (49% portion of the financial amount). Eximbank currently has $175.1 million outstanding of the authorized amounts.

Additional support may be requested in FY 86 and FY 87, but it has not yet been clearly determined whether Eximbank will be permitted by the administration to do so, as recently stated by the Department of State:

"We will continue to review on a case-by-case basis all proposed Exim transactions in Angola in light of our foreign policy objectives; to reach a negotiated settlement on Namibian independence under UNSCR 435 and Cuban troop withdrawal from Angola, and to encourage a peaceful resolution of Angola's internal problems.

"This administration will not approve transaction that conflict with our foreign policy objectives.

"Specifically this means we will not approve U.S. exports to Angola with a military end-use and we will not support Angola's ability to earn foreign currency and thus fund its war against UNITA until the Government of Angola demonstrates clear intent to reach a negotiated settlement.

"Within this context, Exim will continue to apply its usual business analysis of risk to loans and loan credits to Angola, which are not, in any case, grants in aid. They support American exports and American jobs. There are alternative western suppliers eager to take our place in this lucrative and growing market."

Mr. OBEY. Is it inconsistent for the United States to provide assistance to finance the expansion of petroleum production in Angola while at the same time aiding UNITA, an anti-government guerrilla movement? Don't the operations of Chevron/Gulf help to finance the Angolan military as well as the Cuban troops in Angola?

Mr. BOHN. One can draw the conclusion that it appears inconsistent for the United States to provide assistance in financing the expansion of petroleum production in Angola while at the same time aiding UNITA, an anti-government guerrilla movement. The major source of revenue of the Government in defraying its expenses is earnings from the oil sector. The anti-government guerrilla activity could include sabotage of Gulf Oil facilities and thus jeopardize repayment to Eximbank.

## I-MATCH SCORING

Mr. OBEY. Mr. Mrazek told me that you, the administration, intended to pursue its pursuit of the I-match approach rather than the direct approach and indicated that you felt that CBO was going to turn around on their judgment about scoring.

Mr. BOHN. Well, I hope I didn't indicate that I thought they were going to turn around. What I tried to say was that my understanding is that a final decision has not yet been reached by CBO. Despite the implications and indications given by the testimony, my understanding is that this issue is still under some review.

Mr. OBEY. For the moment they take the position that it ought to be scored?

Mr. BOHN. They seem to.

Mr. OBEY. And if we are going to mark up a bill in three weeks, which we are, where does that leave us?

Mr. BOHN. Well, I guess the only answer I can give you to that, Mr. Chairman, is the following. As you know better than——

Mr. OBEY. Shall we provide zero for everything?

Mr. BOHN. Well, I think if it's a choice of zero or something, we have tried to make a case that our best judgment is that the $1.8 billion request meets the needs of the exporters. As to the export support mechanism we use, the administration has requested the I-match program, which we believe for the reasons stated previously makes sense. There is no request in the President's budget for direct lending, and I guess all I can say is that having tried to establish the needs of the exporting community, how that comes out really is out of our hands.

Mr. OBEY. Well, let me say something here. Again, I know it is not your fault. We have a lot of squawking going on because people say the budget process doesn't work, the budget process doesn't work, we hear it ad nauseum. They are absolutely correct, the budget process doesn't work. But I will tell you something. Since 1921 it's been the President that has been obliged to begin the process of creating a budget, and during that time we have had over 60 years and 10 Presidents who have taken that first step and laid out what they thought was a realistic budget.

But in recent years we have had the other problems. Over 90 percent of the resources of the Federal Government and executive branch of government, when it comes to putting together a budget, a small amount of stuff that we have by way of the Budget Committee and CBO and others to compete in that regard is minuscule in comparison to the resources at the command of the executive branch and President and White House.

When we get a budget which is off the wall in terms of leaving us no reasonable options, when we are told by CBO and by GAO that we can't score it your way, and when the administration says they aren't going to score it the other way, when you have a problem I think that it is irresponsible for the executive branch of government to screw up the process this way, and they certainly ought to have a fallback position which at least recognizes, since both houses of Congress are going to be following CBO base lines by and large, including economic assumptions, this entails other judgments, that they have got an obligation to cooperate.

I mean, normally it is the executive branch which is supposed to be the unifier in this country, it's supposed to be the leader, supposed to be the problem solver, not supposed to be a damn maverick bomb-thrower. If we can't find a way to have the executive branch meet their responsibilities, then there is only one way I know how to meet one, that is to say: Mr. President, until you do yours, down at the other end of Pennsyvlania Avenue, you ain't going to get nothing from us.

I don't know how we can proceed without knowing what the administration's fallback position is.

I know that his decisions are being made at a different level than yours, but you are the only guy here I can talk to today and those are my views.

Mr. Bohn. I appreciate your comments, Mr. Chairman. I guess my comments here are addressed to what we perceive as quite a legitimate need for the exporting community. The process by which we get there is at best uncertain at this stage, but——

Mr. Obey. The administration is turning it from uncertain into chaotic, and that is a destructive, pointless thing to do, especially when GAO says that the way you boys want to do it will cost more money. Now, every time I do anything that costs one penny, I get some Republican somewhere lecturing me on fiscal responsibility. And yet for two years in a row you come up with a proposal that we are told spends more money than if we did it the old way. It doesn't make much sense to me.

Mr. Bohn. Well, I think there is some question whether or not the economic cost—it gets very theoretical at this point—some question whether the economic cost is really different one way or the other.

Mr. Obey. The only reason you are doing it is to make your deficit look smaller and to fool people. That is the only reason it is being done. It is a gimmick.

Mr. Bohn. If I could, I would like to offer one comment in response thereto, and that is this. Out of many discussions we tried to create an I-match program which met the budgetary needs to which you refer, but there is also another value, and the other value, as I mentioned before, is that the program does in fact encourage the banks to get back into the export business, and by participating in——

Mr. OBEY. Let me suggest something. Get it authorized, get it straightened out at the authorization level and then come up here and request an appropriate appropriation.

You can have a legitimate argument whether the proposal makes sense, but the timing of it in terms of appropriation is irresponsible and anybody who knows how you have to put together a budget knows that. So I will await some other recommendation from the administration, or they can take the heat for pulling the plug on Export-Import Bank.

That is all. Thank you for coming.

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